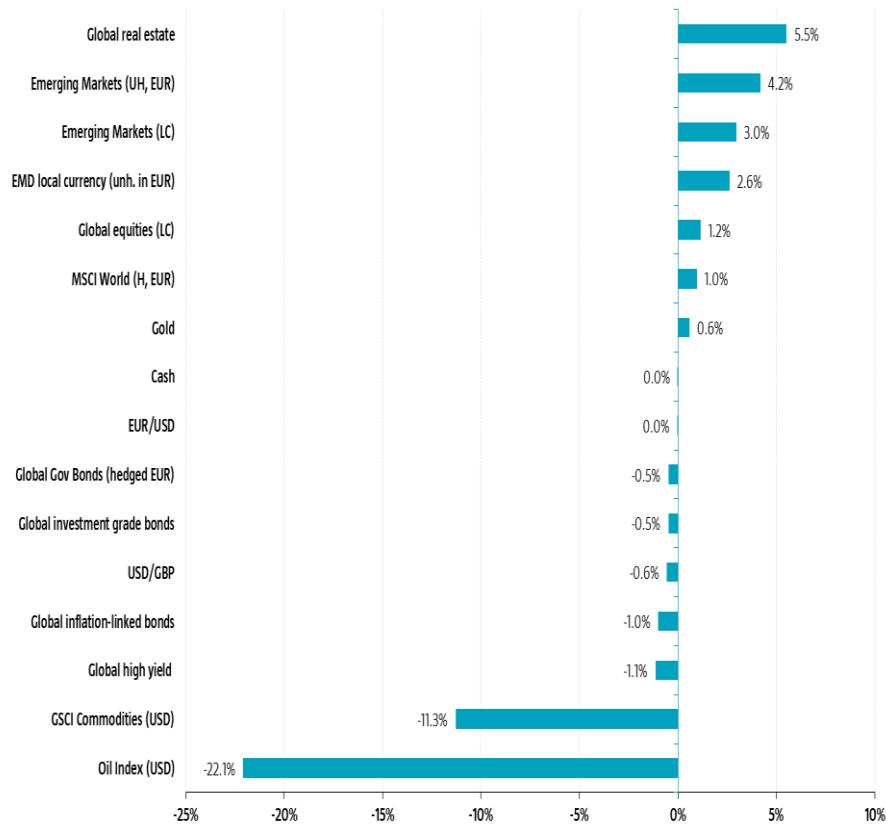


## Multi-asset market outlook

For professional investors  
December 2018

## General overview

### Emerging markets are back!

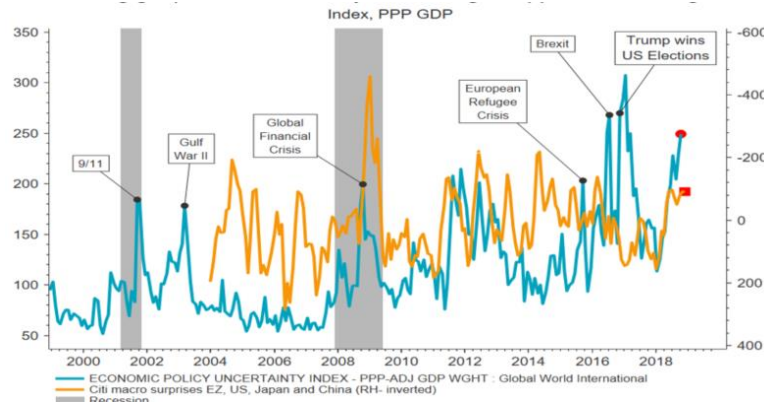


Source: Bloomberg, Robeco

- > From the November performance figures it is very clear that emerging markets are back. Both emerging market equity and debt had a very good month. The clear losers were commodities: crude oil lost almost a quarter of its value. Overall, equities delivered a decent performance in November, while fixed income assets – with the exception of emerging market debt – generated losses.
- > The performance of emerging assets is a clear reflection of changing regional preferences. We are moving away from the US-centric view that has dominated the financial markets the past month. Not that all worries regarding emerging markets are behind us: the trade dispute between the US and China has still not been resolved. However, when it comes to emerging markets, it currently feels like we only need to deal with a lot of known unknowns, and much less with unknown unknowns.
- > In other words, we think that a lot of bad news has already been priced into most emerging asset classes. A major headwind for emerging markets has started to subside: higher US rates, as the Fed seems to have transitioned to a more neutral stance. This also has negative implications for the US dollar, which is likely to depreciate in that case, which in turn is beneficial for emerging markets.
- > With the exception of some minor changes we have kept our positions the same. We remain overweight equities and underweight high yield bonds. We did change the regional tilt of our overweight position in equities to more emerging markets and less US.

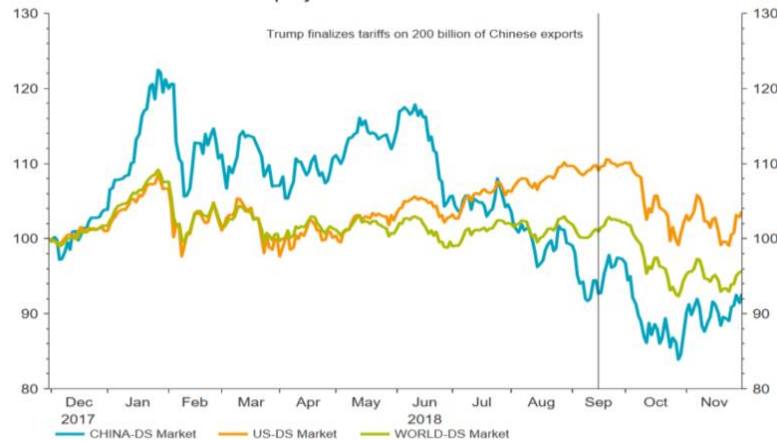
> Theme of the month: Markets see the wind taken out of their sails (I)

Increasing geopolitical uncertainty and rising growth disappointments



Source: Thomson Reuters Datastream, Robeco

Equity markets' performance



Source: Thomson Reuters Datastream, Robeco

> It has been anything but plain sailing in financial markets lately. Despite corporate earnings growth powering ahead this year, risky assets have made little progress, due to a potent mix of headwinds. These range from China-US trade skirmishes, negative economic growth surprises and the Fed progressing to a more neutral monetary policy, to the Italy-EU standoff, the Brexit process entering a critical phase, and a sudden slump in oil prices. As a result, returns in local currency for the global equity market in the year to date were a meagre 0.5% at the end of November. Adding to the complexities of the current investment climate, even a traditional safe haven asset like gold (-7.2% YTD in USD) has failed to shine amidst the recent turbulence. The global monetary tide is going out, and real interest rates (the opportunity cost of holding gold) have increased, as excess liquidity is receding.

> Markets have been confronted with what the sailing community calls a 'Chinese gybe'; the sudden and excessive keeling over of a boat into the windward direction, often as the result of changing windspeed. Back in September, stock market seasonality turned positive, and investors eagerly set sail for an end-of-year rally, encouraged by resilient earnings growth over past quarters. Unfortunately, the speed of the global expansion unexpectedly slowed, as negative feedback loops from rising geopolitical uncertainty to the real economy appeared. This greater geopolitical risk (see graph) coincided with increasing negative surprises on the macroeconomic front in major economic regions, and many investor boats have rolled over as a result.



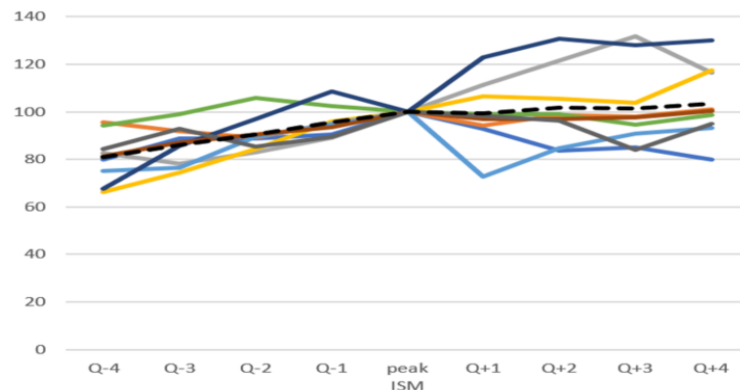
## > Theme of the month: Markets see the wind taken out of their sails (II)

Average ISM around inflection points since 1970



Source: Thomson Reuters Datastream, Robeco

ISM inflection points and MSCI World Index returns (peak ISM =100)

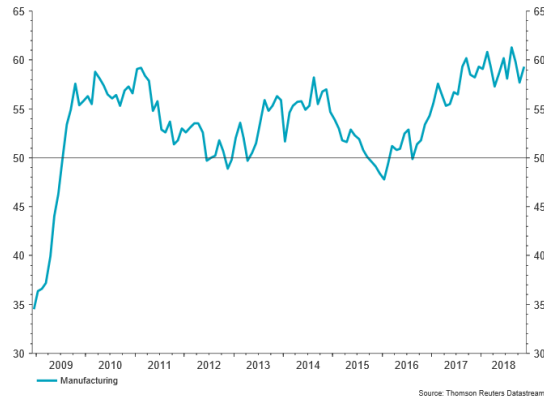


Source: Thomson Reuters Datastream, Robeco

- > The Chinese stock market entered bear market territory in August, declining by 20% from the peak of 26 January, while other equity markets still managed to stay the course. By September, investors became more responsive to the spillover risks beyond emerging economies from the unabating trade tensions between the US and China. On 17 September, President Trump finalized tariffs on USD 200 billion of Chinese exports to the US, while threatening to raise the tariff rate from 10% to 25% in 2019. The pending question for investors is how this Chinese gybe in financial markets will be corrected. Can investors eventually salvage their boats? There are a few hints that they indeed may be able to do so.
- > First, recent comments by Fed Chairman Jerome Powell that the central bank’s policy rate may be ‘just below’ the range of neutral projections by Fed board members could be read as an acknowledgement of being close to an inflection point. However, investors need not fear inflection points, as a deceleration of growth is still a different beast compared to an outright contraction. And as the graph shows, the MSCI World index has managed to generate an average 3.5% return in the four quarters following a cyclical peak in the leading ISM manufacturing index. Meanwhile, geopolitical and economic policy uncertainty could be peaking, with the worst behind us. Sentiment-depressing signals such as the recent inversion of the three-year to five-year US yield curve have to be taken seriously. But ‘bear’ in mind that historically, a recession has emerged on the scene with a significant lag (on average, of 17 months) after an outright inversion of the more important two-year to ten-year section of the yield curve – which hasn’t inverted yet.

## > United States

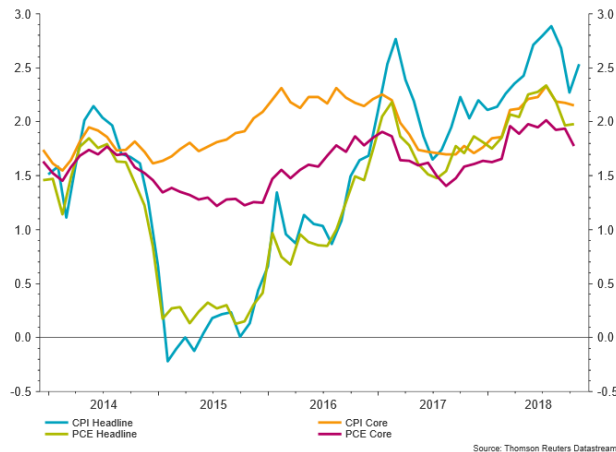
### November ISM manufacturing index rebounds to 59.3



> The US ISM manufacturing index rose to 59.3 in November from 57.7 in October, much stronger than the expected 57.6. The US manufacturing sector is still doing fine, despite growing uncertainty over global growth.

> The core inflation indicator preferred by the Fed – the change in the underlying personal consumption expenditures index – declined in December to 1.8%. This is its lowest level since February, despite strong consumer spending. Other economic indicators, such as business spending on equipment, the deteriorating trade deficit and a weakening housing market, suggest a slowing of the US economy in the fourth quarter from its robust 3.5% growth pace in the third. The Atlanta Fed forecasts a still healthy 2.8% growth rate.

### Core PCE declines to 1.8%



> Fed Chairman Jerome Powell recently signaled that the central bank is nearing an end to its current rate hiking cycle. He declared that the Fed's policy rate was now "just below" the neutral rate, i.e. the level that neither brakes nor boosts the economy. A December rate hike is almost certain, but for 2019, the futures market is currently pricing in only one additional rate hike.

> Plans to raise tariffs on Chinese products from 10% to 25% at the end of this year have been postponed for at least three months. Negotiations with China will be led by the long-time trade hardliner Robert Lighthizer. This does not sound promising at first sight, but it remains to be seen if the unpredictable US president really intends to escalate the trade war.

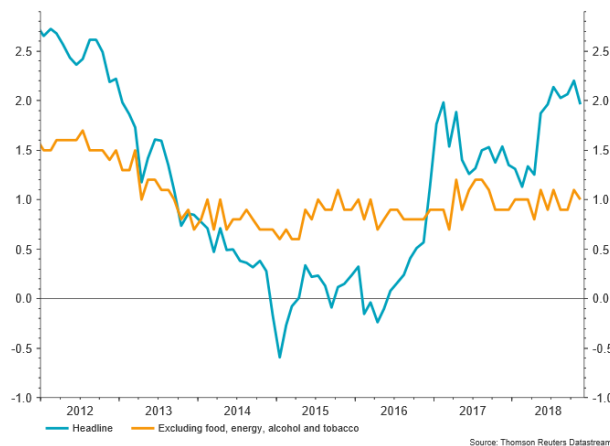


## > Europe

### Continued growth slowdown in the manufacturing sector



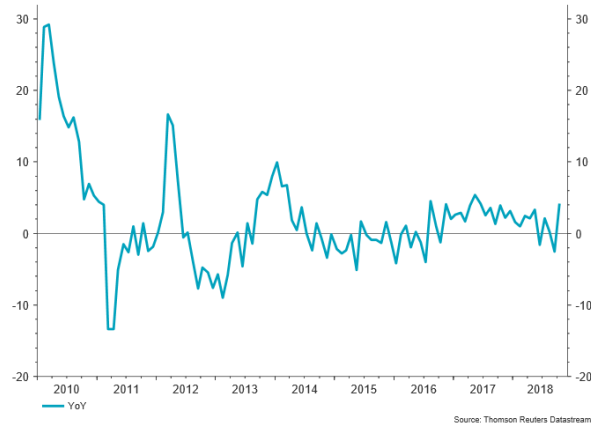
### Eurozone inflation is dipping back



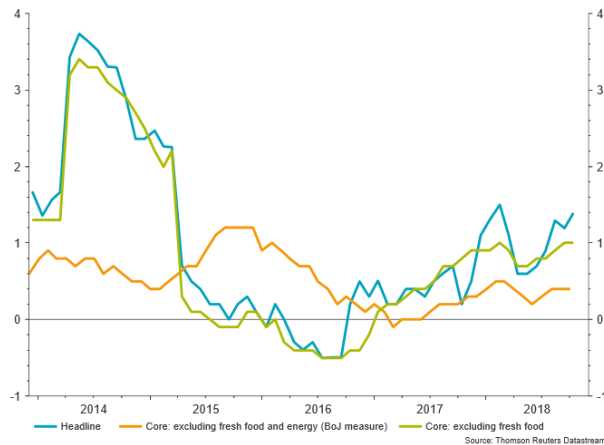
- > The Markit Eurozone Manufacturing PMI in November continued to fall from 52.0 to 51.8. Still, it stayed above 50.0, signaling continuing expansion. Growth was hampered by problems in the German auto sector, which is experiencing difficulties in adjusting to new emission norms, and a lack of export demand due to the weakening of China as a consequence of the trade war. Continuing political uncertainty around Brexit and the Italian budget are also taking their toll.
- > Pressure on the Italian government to seek a compromise with the EU is growing, now that the Italian economy unexpectedly shrunk in the third quarter. It is likely that Italy will drift into a technical recession in the fourth quarter.
- > A parliamentary majority in the UK backed a proposal that parliament should have a free hand to determine what happens next if PM May's compromise Brexit deal is rejected on December 11, which is considered to be very likely. The majority of people don't want the UK to leave the EU without a deal. As a consequence, the likelihood of a second referendum, or a Norway-style membership of the EFTA has increased.
- > Headline inflation in the euro area declined in November, due to lower energy and food prices. Core inflation, excluding alcohol, energy, food and tobacco, fell back as well to 1.0%. Worries over a weaker economy apparently continue to dissuade businesses to pass through higher input prices such as increased wages. Pressure is growing on the ECB to modify its long-standing view that growth risks are broadly balanced.

## > Japan

### Surge in Japanese industrial production



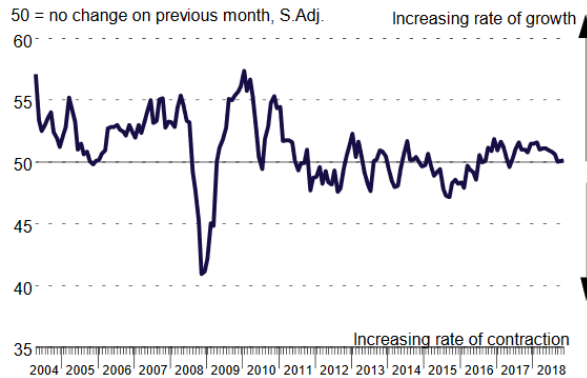
### Japan's 'core core' inflation is stable at 0.4%



- > Japan's fourth quarter started on a positive note, with industrial production increasing 4.2% on a yearly basis in October. This news followed the contraction of GDP in the third quarter by 1.2% on a yearly basis. It suggests that this contraction is transitory, and was primarily caused by the typhoons that caused severe flooding in western Japan in July and the earthquake that hit Hokkaido in September.
- > Further proof that the Q3 dip is temporary were retail sales figures in October, which grew 3.5% on a yearly basis, the fastest pace in 10 months.
- > Japan's exports also rebounded in October from a decline caused by the natural disasters. Shipments to Asia are sluggish due to China's slowdown as a consequence of the Sino-US trade war.
- > The core-core inflation index excluding both energy and fresh food – the gauge preferred by the Bank of Japan – was unchanged at only 0.4% for a third straight month in October. The Bank of Japan's massive asset purchase program has reached a new milestone: its assets are now larger than Japan's GDP. There is no consensus on how large the holdings of a central bank could rise before becoming worrisome, but a growing sense of unease is understandable. With a sales tax increase from 8% to 10% looming for October 2019, and an end to the building boom for the 2020 Tokyo Olympics, there is no end in sight to the program of asset purchases.

## > China

### November's Caixin China General Manufacturing PMI inches up



Sources: IHS Markit, Caixin.

### The Chinese yuan is strengthening a bit on G20 truce



- > The Caixin/Markit General Manufacturing PMI for November of 50.2 was little changed from October's reading of 50.1, signaling a marginal improvement in the health of China's manufacturing sector. The sub-index for new orders continued to rise, suggesting improved domestic demand, due to a recent host of government measures aimed at stimulating the private sector. The sub-index for new export orders, however, declined further, reflecting the impact of the ongoing trade war with the US.
- > The US president claimed to have struck “an incredible deal” when he concluded an uneasy temporary truce with Chinese President Xi Jinping at the G20 summit in Buenos Aires. The US will continue to impose a 10% tariff on up to USD 250 billion of Chinese goods, but it won't carry out its threat to raise them to 25% in January. China, which countered with tariffs on around USD 110 billion of American goods, will lower some tariffs on American-made autos, and resume buying soybeans and other agricultural commodities.
- > China and the US have initially given themselves 90 days to find a framework from which to construct a new trade agreement, which seems a very short time window for such an endeavor. Moreover, the appointment of trade hawk Robert Lighthizer as chief US negotiator doesn't look promising. On the other hand, Trump has already hinted on a possible extension to the 90-day truce, which seems very likely. The yuan rallied to a three-month high on the news of the trade truce.

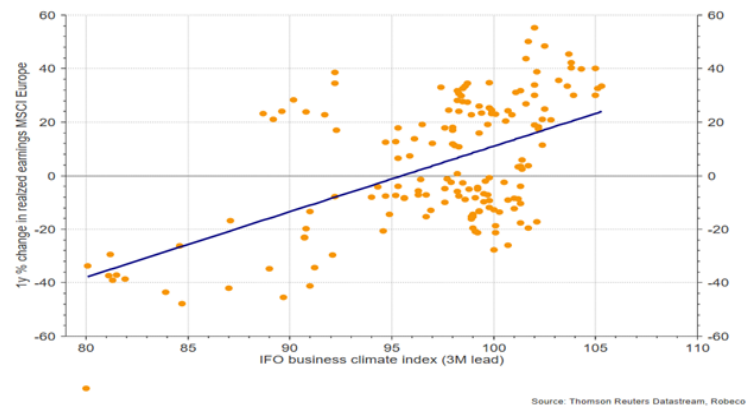


## > Equities (I)

### Earnings revisions are trending lower, but the US still sees net upgrades



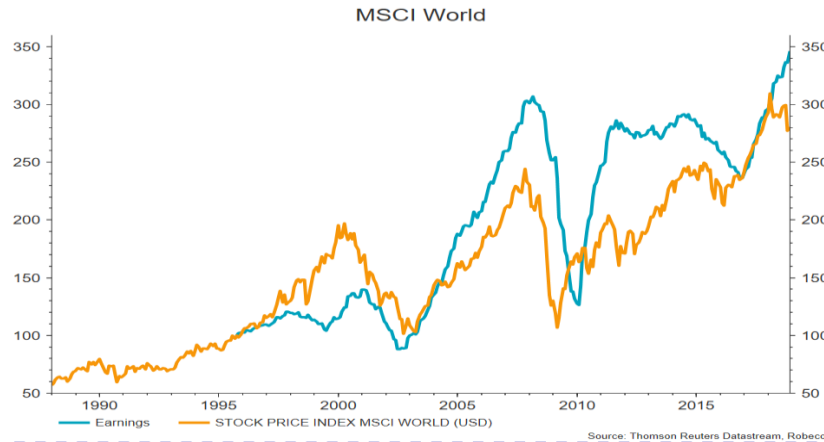
### High-level German producer confidence suggests earnings remain solid



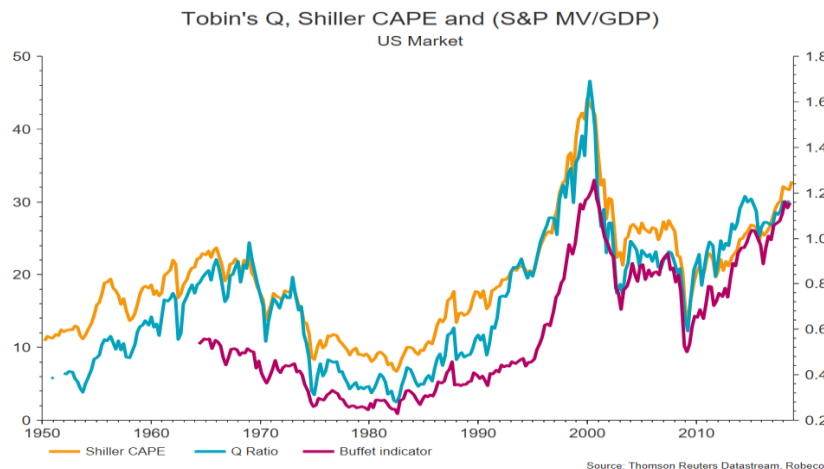
- > How healthy are listed corporate earnings? In general, reported earnings growth numbers were solid throughout the summer. This has forced analysts to keep upgrading 12-month forward earnings for the US on the back of continuing economic expansion. However, not all corporates are created equal, as earnings revisions in other regions show net downgrades. Concerns about broadening US-China trade tensions and a frail truce on car tariffs have contributed to lower analyst optimism on forward earnings for Europe, China and the Asia-Pacific region. For Europe, worries are being aggravated by the renewed tension in the Eurozone following a clash between the EU and Italy on the Italian government budget.
- > Still, analyst estimates of European 12-month forward earnings growing by 9% look a bit too conservative. For instance, an IFO business confidence level of 103.7, which was seen in September, has in the past 20 years never been followed by year-on-year realized earnings growth that was less than 20% in the following quarter.
- > So, given where economic fundamentals stand for Italy, one of the key countries in the Eurozone, European earnings should be able to withstand a negative shock emanating from Italian debt markets. Or, phrased differently, a lot of additional bad news needs to emerge to derail the strong and stable earnings growth picture. A depreciating euro could provide additional earnings support for European exporters, although the three-month correlation between equity performance and the euro is still positive.

## > Equities (I)

### Stock prices have slowed compared to earnings, improving valuations



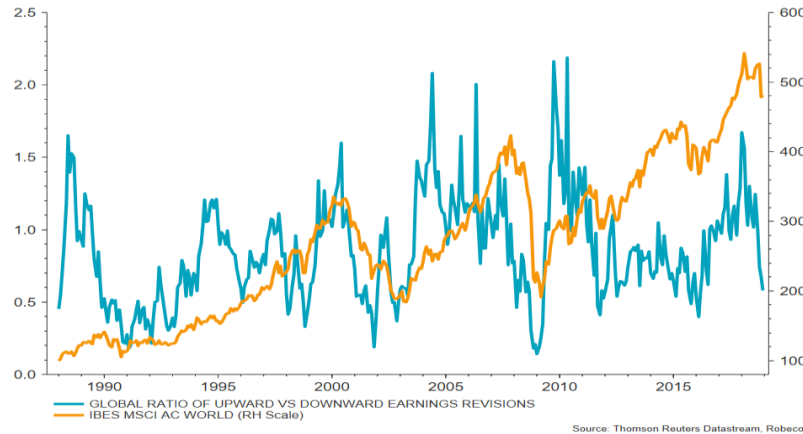
### US market still looking pricey



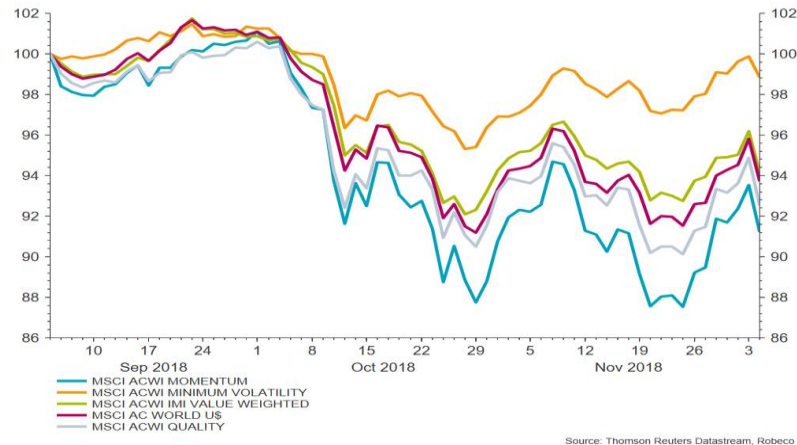
- > The ink of our 2019 outlook entitled 'Turbulence ahead' had not yet dried when the said turbulence that we anticipated for 2019 started to manifest itself in the remainder of 2018. Persistent geopolitical risk and negative macroeconomic surprises have slashed forward earnings forecasts. The global earnings revisions ratio stands at 0.58 and is now firmly in net downgrade territory. Only a while ago, investors had set their hopes on earnings and growth evolving above trend. With economic growth now entering an inflection point as we transition from acceleration to deceleration, global equity investors have abandoned the view that strong earnings growth momentum is set to continue. Instead, the exceptionally strong Q3 S&P 500 earnings growth of 25% (y-o-y) felt more like earnings peaking out, with a subsequent slowdown seen as inevitable.
- > With late cycle fears running high in recent months, stock price depreciation outpaced underlying earnings growth. As a result, global stock market valuations have improved considerably. On a conventional P/E metric, the MSCI All country index is now just below its 23-year average. However, our preferred valuation metric, the Shiller CAPE, is still around 24, which is significantly above the long-term average of 16.5. Also, our other favored valuation metrics such as Tobin's Q (the market value divided by the replacement value) and the Buffet indicator continue to signal that US equities in particular remain expensive. In short, valuations have improved (with notable regional differences, see the Developed Equities section), but the recent market rout still leaves the overall global stock market looking rather expensive.

## > Equities (II)

### Earnings revision ratios have plunged



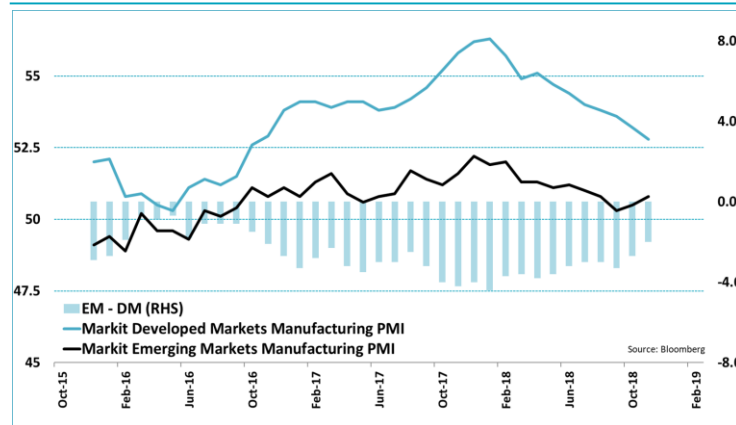
### Low volatility has outperformed other factors recently



- > Investor sentiment has deteriorated, as seen in rising risk premiums, with investors now demanding a higher future earnings stream at a given price level. Retail investors in the US are raising their cash levels as the bull-bear sentiment indicator is now in bearish territory. Historically, at extreme levels (which we don't see today yet), retail sentiment has been a rather contrarian indicator.
- > Despite the subdued sentiment, leading producer and consumer confidence indicators continue to signal that the global expansion remains on track. History shows that expansions tend to continue even if growth downshifts to a lower gear. The market's fear that a recession will occur in the next 12-18 months, based on the recent inversion of parts of the US yield curve, is understandable but premature. First, the important 10Y-2Y curve has flattened, but not inverted, the latter being signal that ultimately matters for recession risk.
- > Second, as explained in our monthly theme, equity markets have still managed to grind higher in a decelerating expansion. Third, stocks have rallied on average for up to four months before a recession hit the economy. That means that if a recession does occur sometime in the next 12-18 months, we would probably still see equity indices at higher levels in the meantime. Nevertheless, the recent curve flattening points to an environment of higher macroeconomic volatility, so it should not come as a surprise that low volatility stocks have outperformed. We remain overweight equities.

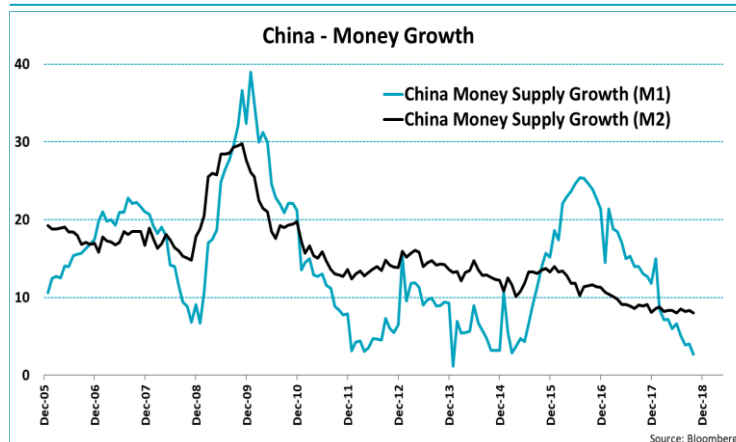
## > Equities: Emerging versus developed (I)

Manufacturing PMI – emerging versus developed markets



Source: Bloomberg & Robeco

Chinese money supply growth



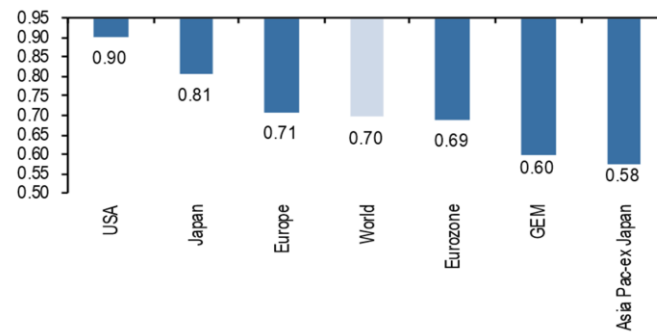
Source: Bloomberg & Robeco

- > Emerging markets posted their best month since January. The asset class realized a return of +4.2% in November, beating the MSCI World Index (in EUR) by an impressive 3.0%. We have upgraded our view on emerging markets to positive, and are now marginally overweight.
- > An important reason for our decision to go overweight was the statement by Fed Chairman Jerome Powell suggesting that the US is now close to neutral policy rates. While this does not mean we won't get a number of additional rate hikes, it does mean that the end of the tightening cycle has appeared somewhere on the horizon. This also implies that the US dollar bull run is mostly behind us. As we have mentioned before, a weaker US dollar is one of the major explanatory factors for the relative performance of emerging over developed markets.
- > In addition, we expect GDP growth momentum to slowly become more balanced between emerging and developed markets. In November, the gap between their respective manufacturing PMIs was the smallest since October 2016. This is the result of a normalization of growth numbers in both developed markets (which was growing above potential) and emerging markets (growing below potential). We expect this trend to continue, also because Chinese government stimulus has yet to show up in the numbers. Money supply growth has not turned, even though more liquidity is being freed up. However, China seems determined to stimulate the economy to counter any adverse effects of the trade dispute with the US.

> Equities: Emerging versus developed (II)

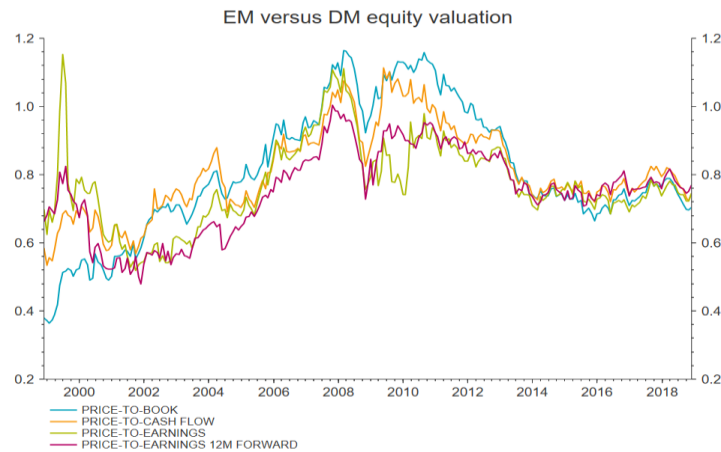
Earnings revisions are downbeat globally, not just in emerging markets

Chart 5: 3 month Earnings Revision Ratio by region



Source: BofA Merrill Lynch European Equity & Quant Strategy, MSCI, IBES

Valuation – the discount is marginally attractive



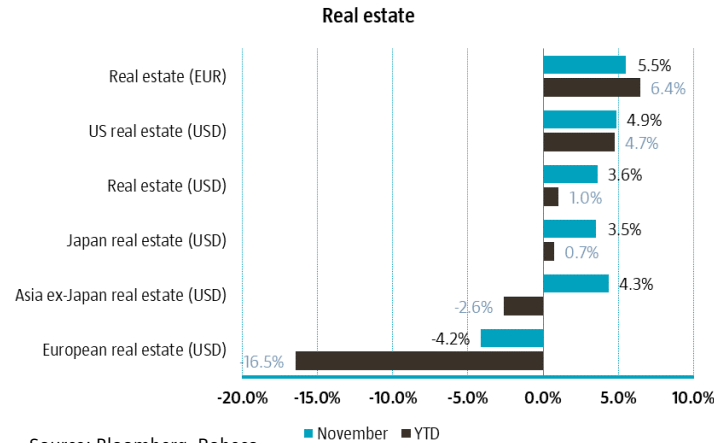
Source: Thomson Reuters Datastream, Robeco

Source: Thomson Reuters Datastream

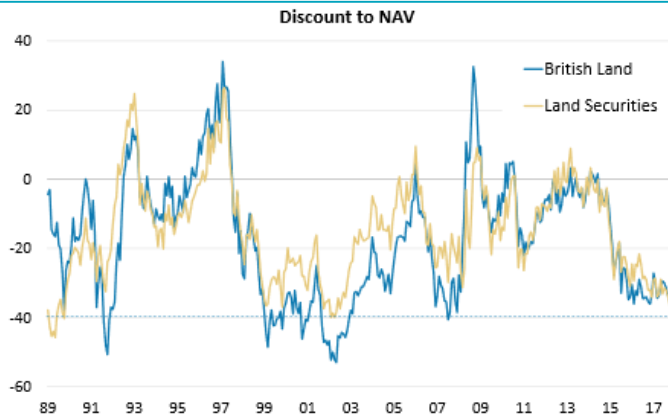
- > From the bottom up, things look far less impressive. Earnings revisions are clearly negative, and have been so for a while. We would like to make two comments here. The first is that towards the end of the year, earnings revisions tend to be negative in general. Second, on a relative basis, other regions are faced with even bigger downward revisions. A good example is the US, where the waning of the effect of tax cuts have pushed the earnings revisions ratio down from extremely elevated levels to below 1. We believe that the recent resilience of emerging over developed markets is partly explained by these developments.
- > We continue to believe that emerging markets offer decent valuations when compared to developed markets. At the same time, we would not label emerging market equities as being outrightly cheap. The discount of 75% is marginally bigger than average – something we can agree with, given the high and uncertain risk profile of some emerging stock markets. When things improve for the asset class as a whole, however, we think valuation will definitely not restrain investors from moving in.
- > We have raised our out outlook for emerging markets to positive, and have implemented a small overweight in the multi-asset portfolio. A more dovish tone by the Fed, a potential peak in the US dollar, and a slow rebalancing of growth between emerging and developed markets are the main reasons for the upgrade. We expect China to keep stimulating its economy, reducing the risk of a China-induced sell-off. Valuations are reasonable, and can become somewhat of a catalyst when investors turn to emerging market equities.

> Real estate

Real estate: regional divergence



The discount on UK real estate is at historical lows



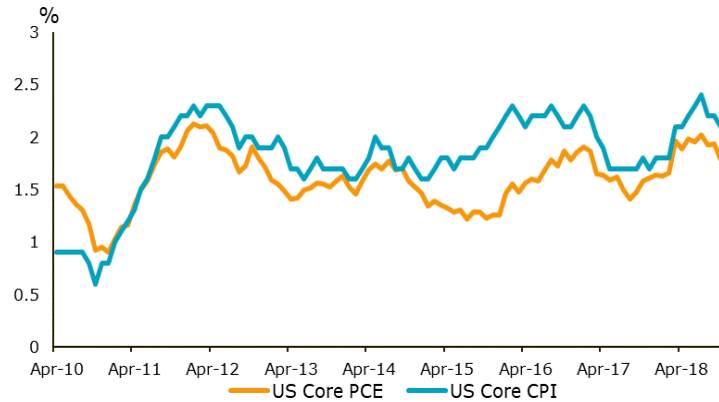
Source: Company data, Datastream, Morgan Stanley Research

- > Global real estate was the best performing asset class in November, as the turbulence in the equity markets didn't seem to affect it. The broad S&P Global Developed Property Index (in US dollars) rose 3.6% last month, while global equities added 1.1%. October's outperformance (in a negative market) was 3.3%. Starting as an underperforming asset class in the first nine months of the year, real estate is now suddenly the best asset class of 2018.
- > However, at the regional level, there are some striking differences in performance. The US real estate market, which counts for more than 50% in the Global Property index (just like equities), outperformed Japan and Asia. European real estate remains a clear underperformer and has already lost 16.5% of its value since the start of the year.
- > The main reason for the European underperformance can of course be found in the UK. Brexit has had a huge impact on the market, both in London and the rest of the UK. All market segments, but especially retail and malls, are suffering. This makes UK real estate relatively cheap, trading at a 40% discount to NAV. In Europe, Germany is a bright spot, as the situation in France or the Netherlands for retail real estate is similar to the UK: e-commerce weighs heavily on the retail space.
- > Meanwhile, US real estate has benefitted from the strong economic environment and a reversal in the preferred investment style of the market. Value-oriented real estate is becoming more attractive, also because the correlation with US Treasury yields has diminished.



> AAA Bonds (I)

**Inflation: both core CPI and Core PCE are decelerating**



Source: Bloomberg & Robeco

**Weakness in housing: supply rises to 7.4 months**

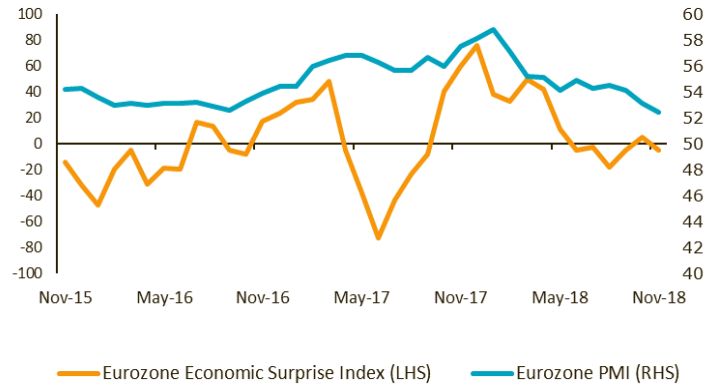


Source : Bloomberg & Robeco

- > While idiosyncratic events will always have an impact on bonds, we are currently in a phase where the path of global yields is for a large part determined by US yields.
- > That the US is the furthest along the policy cycle was very visible in past quarters. The growth divergence between the US and the rest of the world accelerated further. The consequence of this is that Fed policy is dominant, and this effects yields across the globe.
- > Up until recently, the consensus was that the Fed had a tightening bias, and that more rate hikes were more likely than less of them. This belief, however, needs to be questioned following the latest Fed comments. Is this shift in tone just a reaction to the increased volatility of risky assets? In other words, is the famous 'Fed put' back? Or should this be seen as the first indication that the Fed is becoming less firm on the outlook?
- > While the general growth story still seems solid, we are starting to see some cracks appear. Interest rate-sensitive sectors such as housing and autos are starting to show some weakness. Also troubling is that after reaching its five-year high, core CPI has slowly started to drift lower. This is also visible in the Fed's preferred inflationary gauge: core PCE. While still at a relatively high level (not too far away from 2%), this should be a worry for the Fed. We are not worried yet, but will monitor these developments carefully.

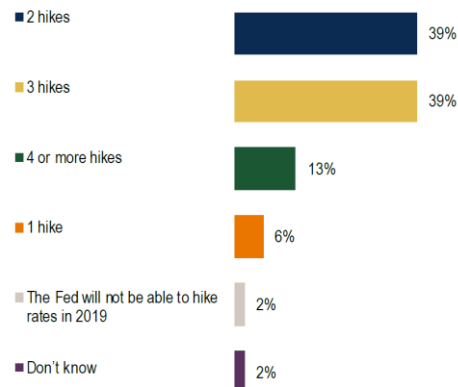
> AAA Bonds (II)

**Eurozone: European growth is still decelerating**



Source: Bloomberg & Robeco

**A more dovish Fed: the market is starting to adjust its expectations**

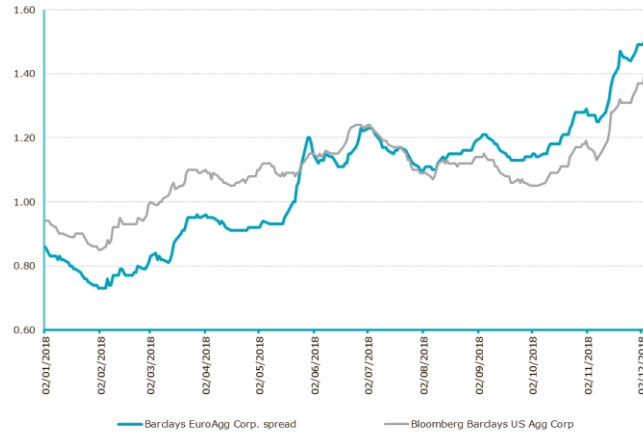


Source: BofA Merrill Lynch FX and Rates Sentiment Survey

- > We find it encouraging that bonds failed to offer much protection against falling equity markets in the recent downturn. While the S&P 500 is currently trading roughly 5% lower than the high it reached back in September, the 10-year US Treasury yield only dropped around 3 basis points over the same period. This indicates to us that the underlying force still is upwards for US yields.
- > Growth continues to disappoint in the Eurozone. The Purchasing Managers Indices continued their descent, but it was comforting that they remained above the 50 threshold. So, growth is still positive and is only decelerating. An added worry is that just like in the US, the latest inflation numbers for the Eurozone also came in weaker. The Eurozone also continues to deal with political uncertainty. This is probably the reason why German yields dropped more during the latest equity market sell-off than US Treasuries.
- > Still, given all of this, the ECB will still end its quantitative easing program in December, and we continue to think that September 2019 remains on the table for a first rate hike.
- > We remain of the view that we haven't yet reached the peak in yields for this cycle. However, worries are growing. While we remain underweight bonds, we have decreased the size of the position.

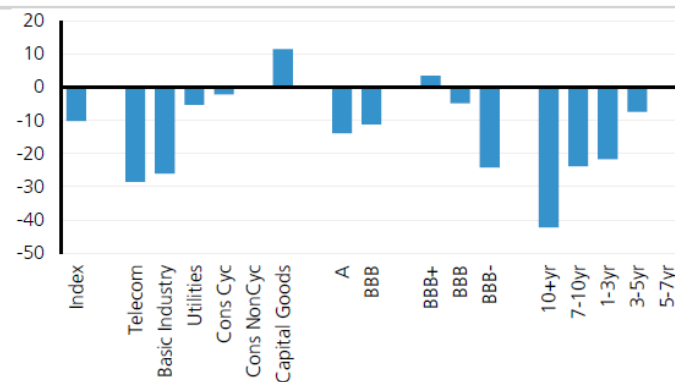
> Investment grade credits (I)

European spreads jump



Source: Bloomberg, Robeco

Spread risk concentrated in specific buckets

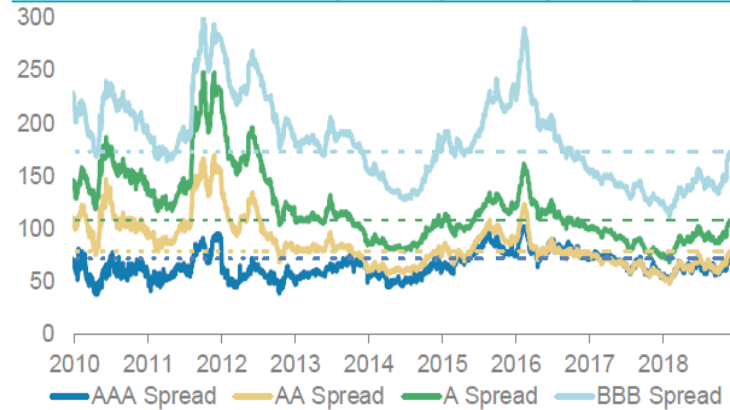


Source: ECB, Bloomberg Barclays Index Services Limited, UBS

- > European spreads continued their rise and jumped in the first half of November to levels nearing 150 bps, and are now twice the level we saw back in February. Yields also increased, but remain low in an historical context. The European credit yield ended November at 1.30%. Although it wasn't an outright sell-off, it was yet another drag on the already disappointing return: -1.4% YTD, the worst in years. The rise in European credit spreads was due to a mixed bag of mostly known risks that have worried investors in 2018, led by Brexit and the Italian budget discussions. A new element, however, was the increasing pessimism on economic growth, which also sent equity markets down last month.
- > Looming on the horizon is the ECB retreating from the market as its ultimate credit buyer after January 1. Although that doesn't come as a surprise, prices doesn't seem to reflect this yet. The graph on the left shows the discount that is still priced into the spreads when one compares the situation where CSPP is still in place with one without it. The conclusion seems to be clear: most sectors, especially the long end bucket, trade at lower spreads than would be the case without CSPP. Once the ECB stops the CSPP program, it is likely that pressure on spreads will increase.
- > We expect that European spread widening will continue, but only mildly. CSPP won't help the markets anymore. The known political risks (Brexit, Italy) will still be there at the start of 2019, as will the trade war between the US and China.

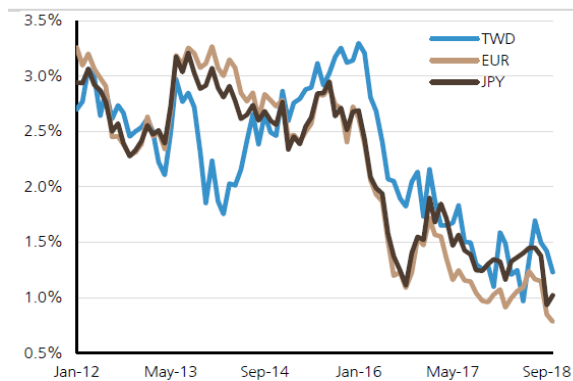
> Investment grade credits (II)

US credits



Source: Morgan Stanley, FTSE Fixed Income LLC

US investment grade credit yields hedged into foreign currency



Source: Bloomberg, UBS

Source: Morgan Stanley

- > The US credit markets also faced a sharp rise in the credit spread in November, up by 19 bps to 1.37. The yield rose to 4.37%, and is now back to levels we saw at the start of this decade. The tailwind of the strong US economy supported the credits markets in 2018, but the decelerating growth that is expected in 2019 caused end-of-cycle fears among investors, with higher spreads as a result.
- > The spread widening was also fed by the declining oil price, as the US credit index is more vulnerable for oil-related issues than his European counterpart, due to its relatively high percentage of energy companies. These companies are mostly rated as BBB, the segment that saw the most spread widening.
- > A yield of more that 4% in US credits seems pretty attractive, but corrected for hedging costs, the graph on the left shows clearly that for some important currencies, not much yield is left. The flows out of US credit will continue. We expect a further spread widening in the US going into 2019.
- > We currently have a neutral stance on credits. But we're very cautious as growth prospects for 2019 are lowered, and as central banks are tightening.

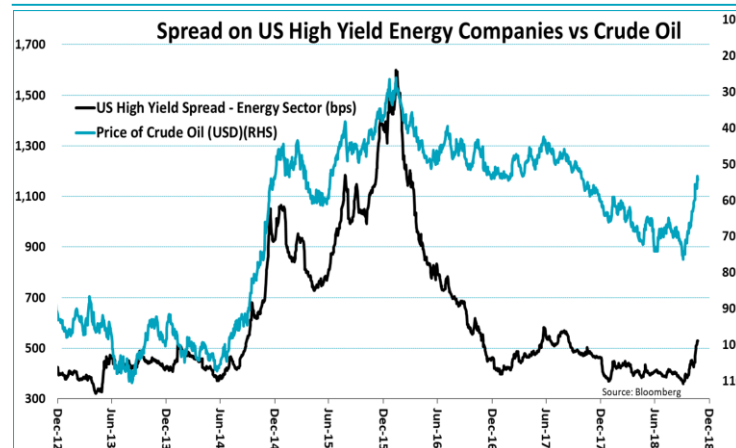
> High Yield (I)

High yield – spread



Source: Robeco & Bloomberg

High yield – energy companies and oil price

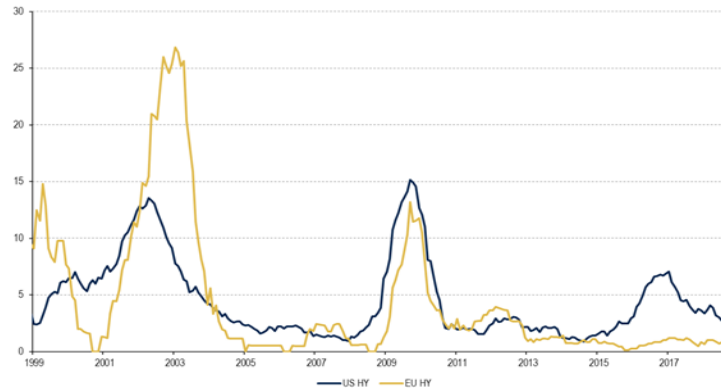


Source: BofA Merrill Lynch & Bloomberg

- > Prices of high yields bonds fell again in November. The asset class realized a negative return of 1.1%, the worst reading among all fixed income asset classes. For the year, high yield bonds are down 4.4%. At the end of November, the average spread had risen to 4.74%, the highest level in over two years.
- > While we expect the global economy to remain healthy, recent macroeconomic numbers have disappointed. This has led to higher uncertainty among investors. While we believe that a recession will not occur in the next 12 months, high yield bonds remain relatively vulnerable to less upbeat economic projections. As the chart on the top left shows, spreads are still contained, although they have widened considerably in recent months. Given that bond yields remain depressed, especially outside the US, they don't offer much of a buffer against less abundant times. This is something we have emphasized in recent months, and in our recently published 2019 market outlook.
- > Dwindling oil prices also took their toll on high yield bond performance. Oil prices are down 30% from their high, as fears of a supply glut replaced fears of too little supply in just a matter of weeks. As a result, the spread of high yield energy-related companies have started to rise again. As the chart on the bottom left shows, spreads are nowhere near the levels we saw in 2015-2016, when prices for a barrel of oil fell to the mid USD 20s.

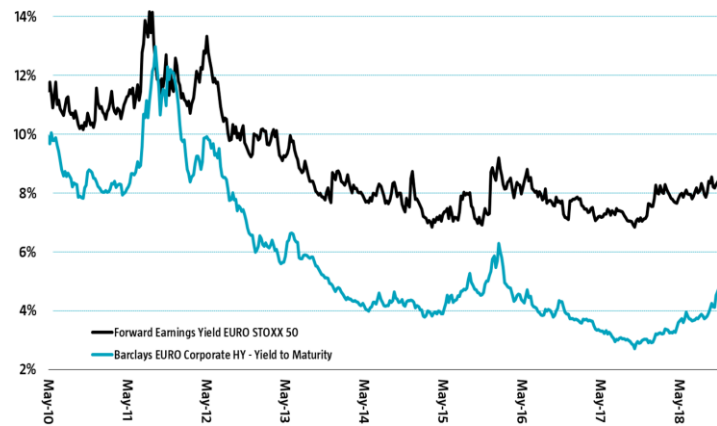
> High Yield (II)

High yield – default rates



Source: J.P. Morgan

High yield – relative valuation against equities



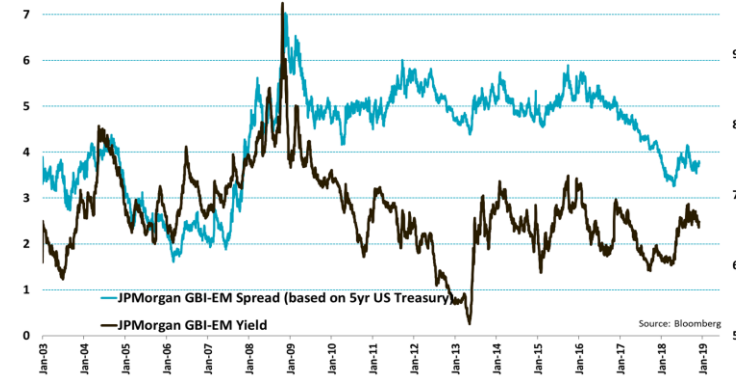
Source: Bloomberg & Bloomberg

- > First, this is because the weakest shale gas producers went bankrupt in 2016. Second, the stronger shale gas companies were promoted to the investment grade index. Finally, the breakeven oil price for shale gas producers has fallen to around USD 40/barrel. Together, these factors help explain why spread widening has been relatively contained so far. That said, we think energy-related high yield companies look somewhat vulnerable if oil prices were to fall further. So, we cannot rule out more spread widening, especially if rates in general go up globally.
  
- > On the positive side, we do not expect a major increase in bankruptcies in the short term for the asset class as a whole. While global growth has certainly weakened, we do not believe we are at the end of the cycle, and expect growth to pick up marginally from here. Although the number of distressed companies is growing, it remains manageable for now. Also, interest coverage remains above average, as earnings growth is solid.
  
- > We remain underweight high yield bonds. Even though spreads have widened, and therefore absolute valuation has improved, the asset class is expensive compared to other classes (see chart). Also, we believe that we are not at the end of the economic cycle yet. This is traditionally a phase in which high yield bonds tends to struggle. Oil prices have yet to stabilize and could add further pressure on high yield bonds. We would need to see a further spread widening to become more constructive on the asset class, but at this point in time, the risk/reward trade-off remains unattractive.



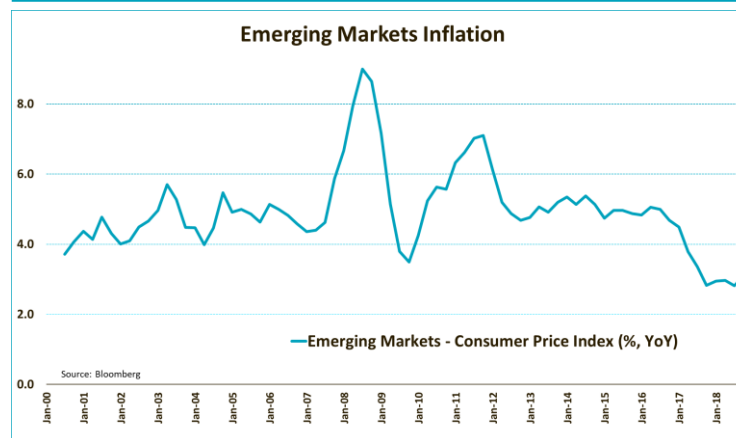
> Emerging market debt (I)

Emerging market debt in local currency – spread and yield



Source: Bloomberg, Robeco

Inflation

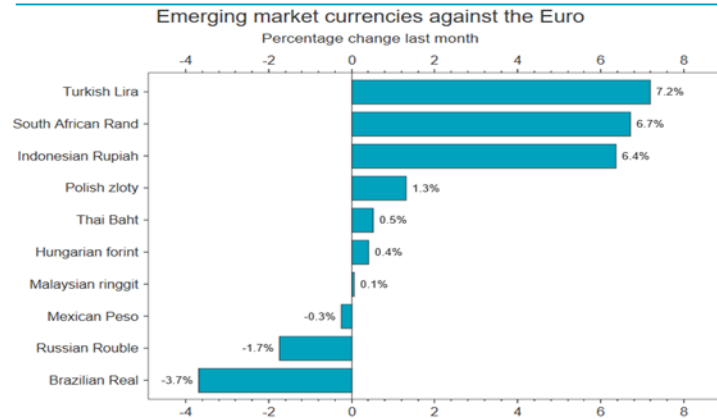


Source: Thomson Reuters, Robeco

- > Local currency emerging market debt posted a solid return of 2.6% (in euros) in November. A major contribution came from emerging currencies, as many of them gained against a weaker euro. As a result of the strong performance in recent months, emerging market debt has almost fully erased the losses sustained earlier in the year.
- > The Turkish lira continued to recover from the massive depreciation in August. Central bank intervention took away anxiety among investors, while inflation fell back more than expected, even though it remains at an elevated level of above 20% for now. And there were no signs of Turkish banks running into trouble with their foreign currency loans. That said, we currently can't rule out that uncertainty about Turkey's economic outlook won't flare up again.
- > With global growth decelerating, but remaining healthy, the outlook for local currency emerging market debt looks pretty OK. While the numbers for individual countries such as Turkey can vary greatly, overall inflation is in fact very low. It has picked up a little, but as the chart on the bottom left shows, headline inflation remains near its lowest level in more than 20 years. This means that, unlike in most developed nations, real rates are significantly positive, which we think is a clear plus for the asset class.
- > Looking a bit further out, other factors may become a positive as well.

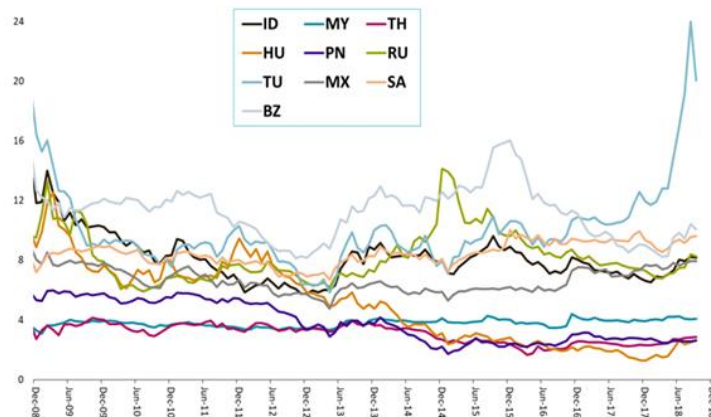
> Emerging market debt (II)

Emerging currencies



Source: Thomson Reuters Datastream, Robeco

Yield to maturity – emerging countries

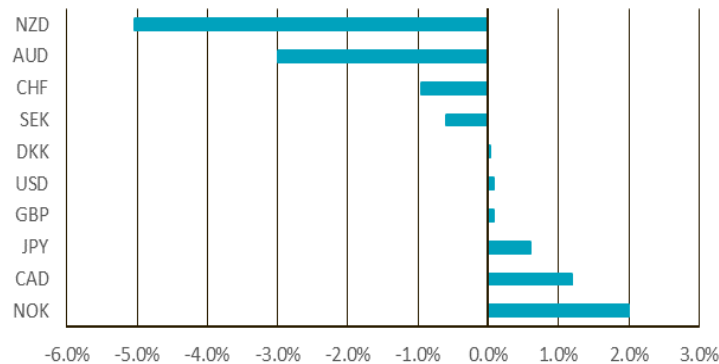


Source: Bloomberg, Robeco

- > Federal Reserve Chairman Jerome Powell’s latest remarks on monetary policy sounded pretty dovish. This means that a peak in the US dollar, although not imminent, has emerged on the horizon. Historically, a weaker US dollar has coincided with solid performance by emerging market debt. Also, we believe that yields on government bonds in developed markets still have to go up, whereas this is less obvious for emerging market bonds, even though some spillovers from developed markets cannot be ruled out. Once the normalization of developed market yields (re)starts, investors could start to fancy EMD.
- > An important risk for emerging debt is China. We doubt that the 90-day trade deal truce will evolve into a general trade agreement in the short term. This could translate into a further weakening of the Chinese renminbi, which would trigger a weakening of other emerging currencies, especially those in Asia. On top of that, fundamentals of some of the major emerging economies – Brazil, South Africa and, again, Turkey – remain vulnerable.
- > We remain neutral for now on local currency emerging market debt. Compared to Eurozone government bonds, they are attractively valued, but currency risk remains pronounced. Also, we have yet to see a turn in the US dollar, which would improve the outlook for the asset class. As for many asset classes, China remains the biggest risk, but overall fundamentals look pretty decent.

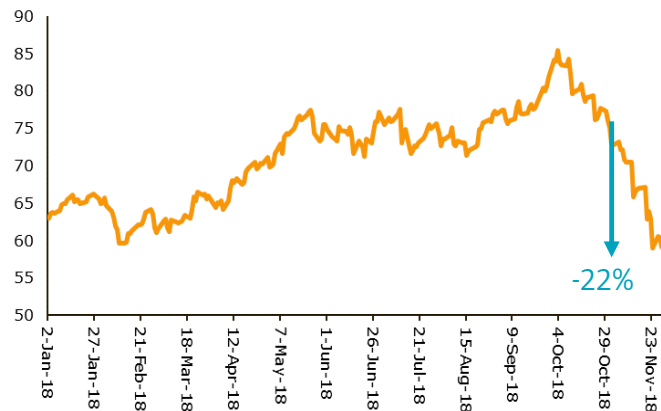
> FX (I)

**G-10 currencies: commodity currencies take centre stage**



Source: Bloomberg, Robeco

**Crude oil: a 22% decline in crude impacted oil-sensitive currencies**

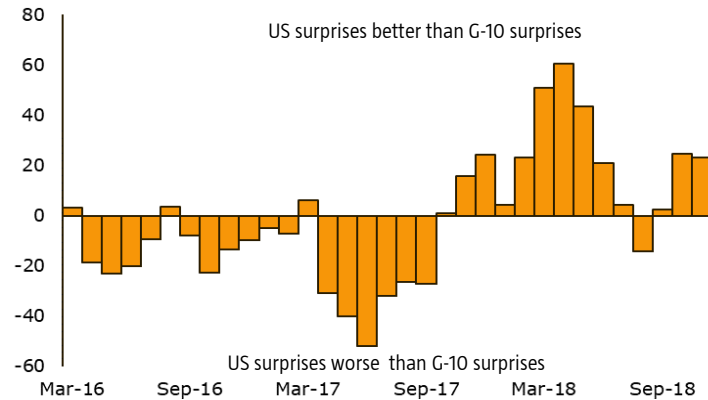


Source: Bloomberg, Robeco

- > Looking at the monthly performances of the G-10 currencies, it is very difficult to find an overall dominant market theme. Still, a few things stand out. First off all this month, there was no clear distinction between so called high yielders or low yielders. More interesting was that the best and worst-performing currencies within G-10 were all so-called commodity currencies.
- > The Canadian dollar and the Norwegian krona both had a terrible month. These oil-sensitive currencies suffered the same fate as crude oil, which lost around 22% of its value in November. The best-performing currencies were those whose fate is more tied to developments in China. Although the trade dispute between the US and China hasn't been resolved, we are starting to see a bit of stabilization, as the Chinese stimulus is finally trickling through. This supported emerging markets, and within G-10 currencies, both the New Zealand dollar and the Australian dollar benefitted.
- > As always, politics remains important for the currency markets, as the controversies over the Italian budget and Brexit are both unresolved. Market attention, however, started to shift towards the Fed, whose policy seemed to have moved from stable and predictable to more uncertain. This was triggered by comments from Powell, who seems to have pivoted towards a more neutral stance. The bottom line of all of this is that Fed policy has become less predictable, and that is something all market participants will have to deal with.

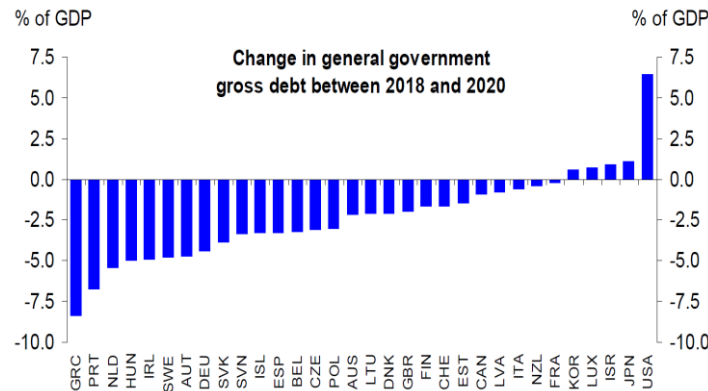
> FX (II)

**Economic surprises: US surprises are still better than G-10 surprises**



Source: Japan MOF, Bloomberg & Jp Morgan

**The US: fiscal policy is not likely to be repeated**



Source: Goldman Sachs Global Investment Research & Bloomberg

- > In 2018, the driving theme of asset markets was growth divergence. US growth outperformed growth in the rest of the world. The question is whether this will continue in 2019, or whether should we start preparing for convergence. Fiscal stimulus boosted US growth and was an important driver of this divergence. As we think the odds are pretty low for another round of tax cuts, and the jury remains out on whether the US president, Republicans and Democrats can find common ground for some sort of infrastructure plan, our base case is that fiscal support will be less of a growth driver in 2019.
- > Convergence doesn't have to imply that other regions accelerate; it could just be that the US starts to slow and disappoints. Currently, softness is limited, and most high frequency data still point to solid growth. However, expectations are also set pretty high, and herein lies the risk. In contrast, the expectations for the rest of the world are low, which leaves room for positive surprises. We have to concede though that the high frequency data for Europe is still decelerating.
- > We currently don't hold any active currency positions in our portfolio. Our bias however is towards a stronger EUR/USD. An easing of political uncertainty will create a window of opportunity for the euro to strengthen. The large current account surplus and relatively depressed growth expectations provide a fruit full backdrop for euro strength.

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