

Peripheral Europe Update

Michiel de Bruin, Co-Manager Robeco Euro Government Bonds
Stephan van IJendoorn, Portfolio Manager Global Fixed Income Macro

- **Italian bond rally as government lowers fiscal deficit target**
- **ECB ends net purchases and acknowledges risks to growth on downside.**

Main market events

Risk sentiment turned positive this week, as the Italian government lowered the fiscal deficit target and China-US trade fears subsided. In this environment peripheral bond markets rallied, with Italy outperforming strongly.

Italy

The Italian government confirmed the fiscal deficit target will be lowered from -2.4% to -2%, a significant concession towards Brussels. Lower growth expectations and market pressures resulted in the Italian government to adjust the target downward. The EC responded that Italy is not there yet. We believe however that this step will be sufficient to delay and possibly even avoid an excessive deficit procedure. Also given recent developments in France, where concessions to 'yellow vest' protesters will lead the 2019 budget deficit to exceed 3%. So, the confrontational standoff between Italy and the EC for now has subsided, a supportive development for Italian bonds, which outperformed significantly past week.

ECB

The technical picture for the European periphery markets is deteriorating as the ECB in Thursday's governing council meeting announced the ending of net bond purchases. Net issuance next year, so gross issuance net of redemptions, will rise in France, Italy and Spain. Especially in the first months of 2019 it is expected that supply pressures are going to be significant. However there are some potential positives as well. With its large stock of European government bonds, the ECB is holding circa 25% of all outstanding EGB's, yearly reinvestments flows will remain sizeable and generally supportive. Also on the political side there is some further progress in strengthening the financial framework of the Eurozone with the announcement of a Eurozone budget and the strengthening of the ESM, the Eurozone rescue fund.

Robeco Euro Government Bonds

On Thursday, after the Italy-Germany spread tightened circa 25 basispoints, we took profit on part of the overweight we had implemented in Italy. Although we acknowledge that the outlook for Italian bonds has become more constructive, the economic and political backdrop remains fragile and it is likely that Italian bonds will still be volatile and could be subject to sell offs. We did hold on to our overweights in Spain and Ireland, versus an underweight in Portugal. In semi core we remain overweight Belgium versus an underweight position in France. Investments in peripheral bonds declined slightly to 41% which is just 1% above the index level as expressed in market value. Year-to-date the fund's absolute return is +0.07%*.

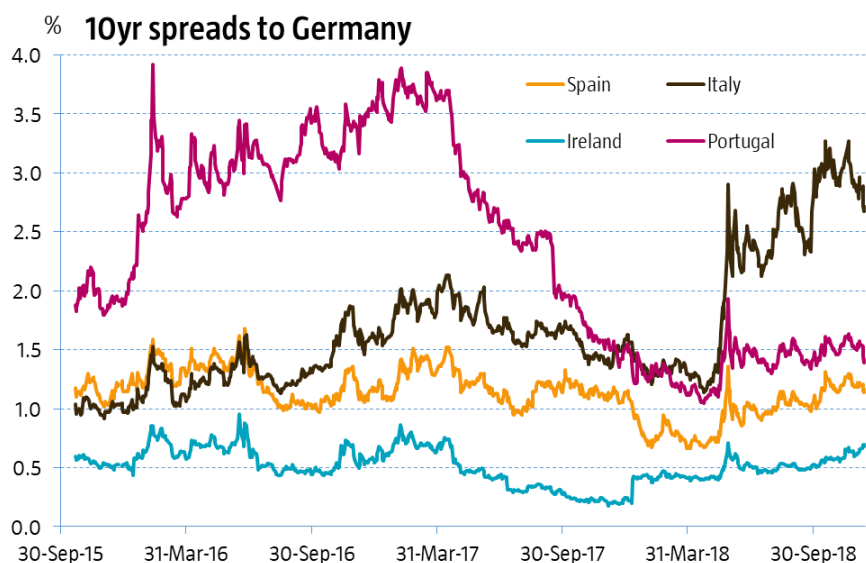
* Robeco Euro Government Bonds, gross of fees, based on Net Asset Value, 14 December, 2018.
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Current 10-yr spreads versus Germany

maturity	Germany	Spreads									
		France	Italy	Spain	Netherlands	Belgium	Austria	Greece	Ireland	Finland	Portugal
1	-0.63	0.01									
2	-0.61	0.17	1.19	0.42	-0.05	0.06	0.07	2.01	0.13	0.09	0.28
3	-0.56	0.26	1.84	0.53	0.00	0.14	0.08		0.11	0.08	0.37
4	-0.44	0.30	2.07	0.57	0.02	0.15	0.15				0.54
5	-0.30	0.32	2.33	0.66	0.03	0.26	0.14	3.58	0.26	0.17	0.73
6	-0.21	0.31		0.87	0.12	0.29	0.22			0.17	0.80
7	-0.10	0.37	2.65	0.99	0.15	0.36	0.27	4.12		0.26	1.20
8	0.02	0.41	2.52	1.08	0.15	0.43	0.31		0.62		1.30
9	0.13	0.39	2.64	1.15	0.17	0.48	0.29				1.35
10	0.26	0.46	2.71	1.16	0.16	0.49	0.26	4.00	0.69	0.31	1.41
15	0.53	0.61				0.65	0.46	4.21			
20	0.69	0.57				0.79					
30	0.89	0.76	2.72	1.73	0.06	0.86	0.48				

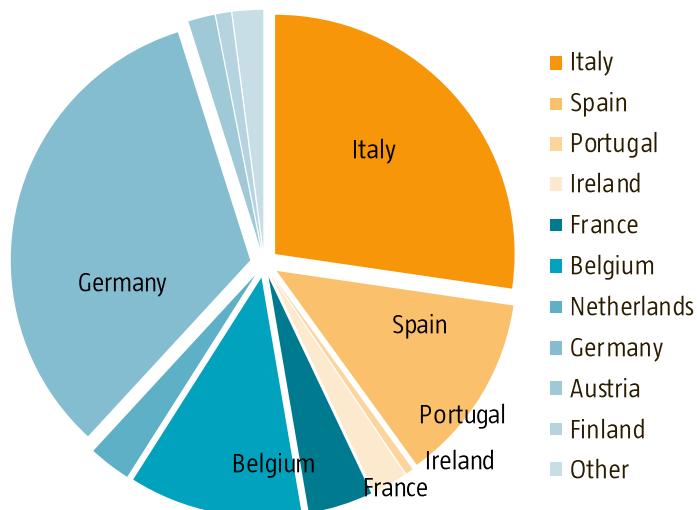
Source: Bloomberg

Movement over time



Source: Bloomberg.

Country allocation Robeco Euro Government Bonds (7 December, 2018)



Source: Robeco

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