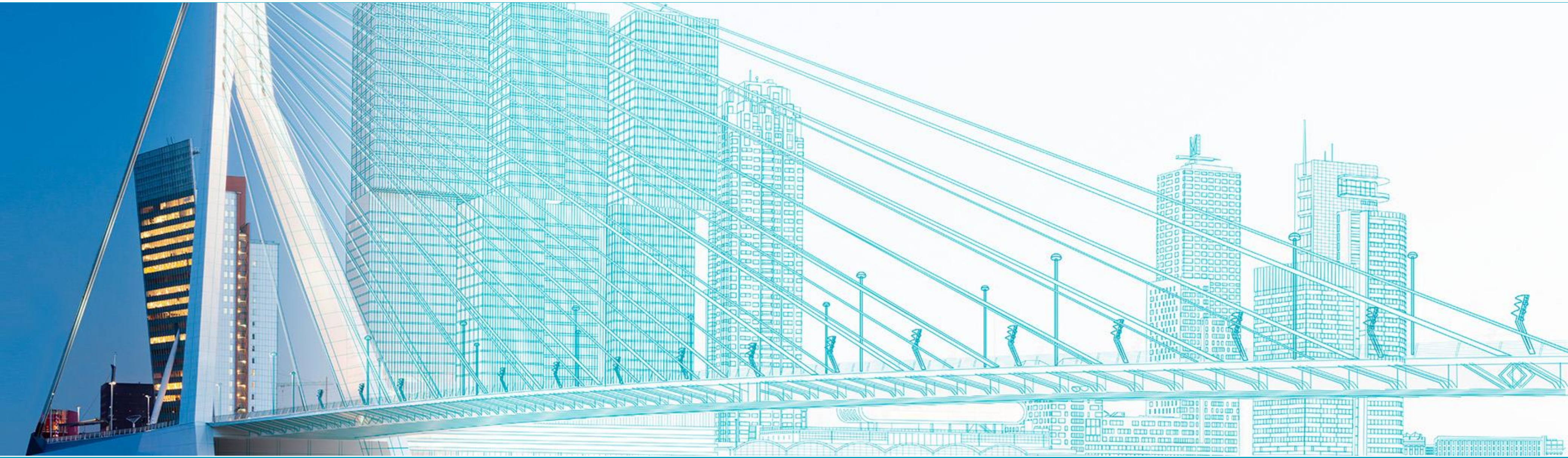
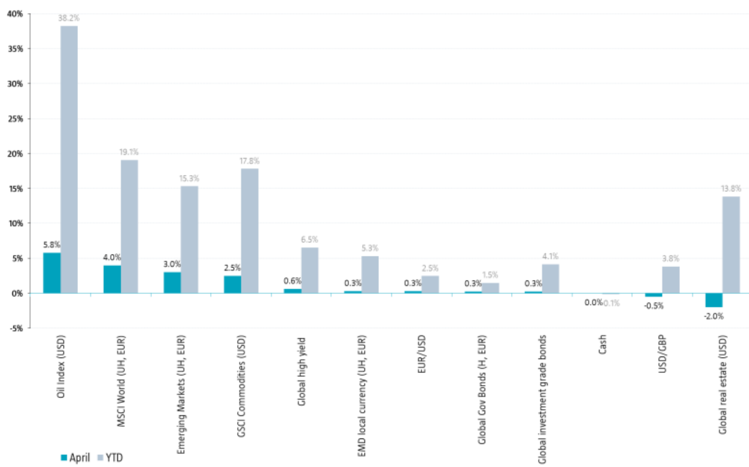


Multi-asset market outlook

For professional investors
May 2019

General overview

Four months in a row for equities this year



Source: Bloomberg, Robeco

Positions: we're cutting equities and adding to cash

	Portfolio	BM	active
Equities Developed Markets	26.0%	25.0%	1.0%
Equities Emerging Markets	5.0%	5.0%	
Real Estate Equities	5.0%	5.0%	
Commodities	5.0%	5.0%	
Core Gov Bonds 1-10	20.0%	20.0%	
Core Gov Bonds 10+	7.5%	7.5%	
Investment Grade Corp Bonds	19.0%	20.0%	-1.0%
High Yield Corp Bonds	2.0%	5.0%	-3.0%
Emerging Market Bonds LC	5.0%	5.0%	
Cash	5.5%	2.5%	3.0%

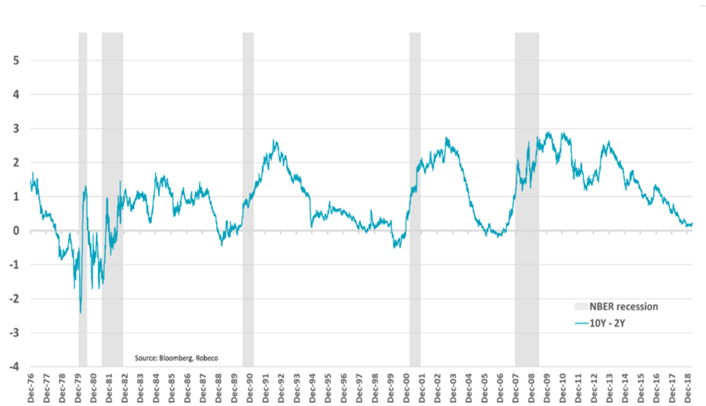
- In the absence of big news, markets ground higher in April. This was the fourth consecutive month of higher stocks, with nearly 20% returns over that time, and a new 'all time high' for the MSCI World (in euros). Not a bad return, but still only half the performance of the oil index during the same period (+39%). In fixed income, the best returns were seen in the riskier segments. US Treasuries and German bunds yielded negatively.

- In line with the market correction in Q4 2018, earnings expectations for Q1 2019 were revised downwards. The consequence of this was that a majority of the companies reported better-than-expected earnings. When you add this to the market-friendly policy of the Fed and ECB, and satisfactory macroeconomic data in both the US and Europe, the equity market's positive performance is easily explained. The question was: what could derail this positive environment for risky assets? Well, President Trump is always a good candidate. In a series of tweets on the trade war, Iran and Israel, he once again tested the resilience of market sentiment. The coming weeks will tell if this was indeed a turning point for sentiment, or just another opportunity to buy.

- We made no changes to the portfolios in April. In the first week of May, however, we reduced risk to steer them towards a neutral stance. We lowered our exposure to emerging markets and developed market equities, and added the proceeds to cash. We are now neutral on emerging market equities and slightly overweight developed market equities to offset underweight positions in credits and high yield.

Theme of the month: There's no need to fear yield curve inversions (I)

10Y-2Y yield curve and recessions



The average countdown to a recession is 19 months

Start date recession	First inversion 10Y - 3M	lag (months)	First inversion 10Y - 2Y	lag (months)
February 1, 1980	November 1, 1978	**15**	August 17, 1978	**17**
August 1, 1981	October 27, 1980	**9**	September 11, 1980	**11**
August 1, 1990	March 28, 1989	**16**	December 14, 1988	**20**
April 1, 2001	September 11, 1998	**31**	May 26, 1998	**34**
January 1, 2008	January 18, 2006	**23**	December 27, 2005	**24**
Average		19		21
Median		16		20

Source: Bloomberg, Robeco

- The US yield curve has (almost) inverted, and this has been making headlines for the last couple of months now. This should come as no surprise, as the yield curve is perhaps the most reliable recession indicator out there. But what does an inverted yield curve tell us about future returns? Our analysis shows that while asset class returns in general are somewhat subdued between the first date on which the yield curve inverts and the start of the recession, the inversion of the yield curve is not followed by extraordinary deviations in returns.

- In most empirical research, the yield curve is either defined by the differential between the 10-year and 3-month US Treasury yield (10Y-3M), or the 10-year and 2-year US Treasury yield (10Y-2Y). For the 10Y-2Y, we have reliable data covering the last five US recessions, all of which were accurately forecasted well in advance, as shown in the table. The lag between the first 'inversion date' and the start of the recession averages 21 months, ranging from 11 months until the 1981 recession to 34 months until the 2001 recession.

- The results for the 10Y-3M yield curve are highly comparable, with an average lead time of 19 months until the next recession. The data further reveals that prior to the last five recessions, the 10Y-2Y yield curve inverted before the 10M-3M yield curve on each occasion. From this angle, the 10Y-2Y yield curve should be the preferred recession indicator, as it 'detects' the next recession first.

Theme of the month: There's no need to fear yield curve inversions (II)

What does yield curve inversion tell us about future returns?

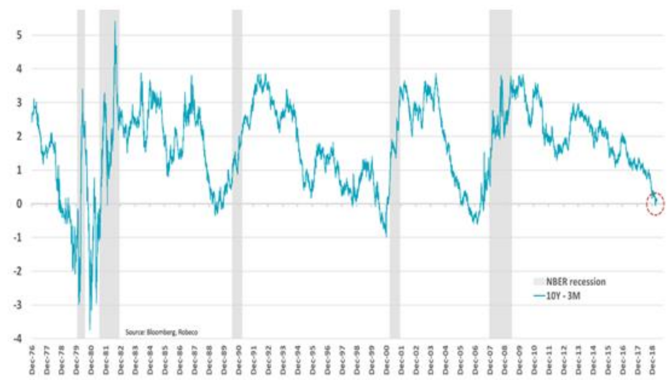
Start date recession	First inversion 10Y - 2Y	lag (months)	S&P 500	MSCI World	Commodities	Gold	Treasuries	Corporates	Real GDP
2/1/1980	8/17/1978	17	6.5%	6.4%	54.2%	124.1%	3.0%	-5.1%	2.5%
8/1/1981	9/11/1980	11	4.7%	-1.0%	-34.0%	-43.5%	1.7%	-4.8%	3.3%
8/1/1990	12/14/1988	20	17.1%	4.2%	7.7%	-7.1%	11.1%	11.4%	3.4%
4/1/2001	5/26/1998	34	2.1%	-0.5%	2.4%	-4.7%	7.0%	5.8%	4.1%
1/1/2008	12/27/2005	24	8.1%	12.0%	4.8%	27.9%	5.9%	4.3%	2.6%
Average		**21**	**7.7%**	**4.2%**	**7.0%**	**19.4%**	**5.7%**	**2.3%**	**3.2%**
Median		**20**	**6.5%**	**4.2%**	**4.8%**	**-4.7%**	**5.9%**	**4.3%**	**3.3%**

Source: Bloomberg, Robeco

Start date recession	First inversion 10Y - 3M	lag (months)	S&P 500	MSCI World	Commodities	Gold	Treasuries	Corporates	Real GDP
2/1/1980	11/1/1978	15	14.8%	8.4%	56.1%	139.1%	3.5%	-5.8%	2.1%
8/1/1981	10/27/1980	9	3.1%	-4.3%	-38.5%	-44.7%	2.6%	-3.2%	4.1%
8/1/1990	3/28/1989	16	16.1%	4.0%	4.4%	-3.5%	13.0%	13.0%	3.1%
4/1/2001	9/11/1998	31	5.6%	3.7%	7.1%	-5.0%	5.7%	5.5%	4.2%
1/1/2008	1/18/2006	23	7.4%	11.5%	5.3%	24.6%	5.9%	4.3%	2.3%
Average		**19**	**9.4%**	**4.6%**	**6.9%**	**22.1%**	**6.1%**	**2.7%**	**3.2%**
Median		**16**	**7.4%**	**4.0%**	**5.3%**	**-3.5%**	**5.7%**	**4.3%**	**3.1%**
Average Annual Return full sample period			**9.4%**	**9.0%**	**2.8%**	**4.8%**	**8.6%**	**8.9%**	**3.0%**

Source: Bloomberg, Robeco

10Y-3M yield curve and recessions



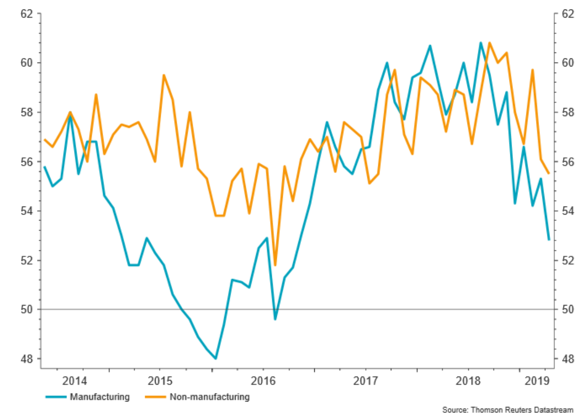
- So, what does yield curve inversion tell us about (future) asset class returns? The table on the left shows the average and median annual returns on most major asset classes. The returns are calculated as the index change between the first negative reading of the yield curve leading up to a recession, and the first day of that same recession. The last row shows the average annual return for the full sample period from 1978-2008. As can be derived from the table, this period was an exceptionally strong period for both stocks and bonds, with average annual returns above their longer-term history.

- The deviation from the full sample average return is relatively large for US corporate bonds. This observation fits the perception that credits tend to struggle late cycle, as short-term interest rates are lifted by the Federal Reserve, and leverage is high. Global stock performance also trails between yield curve inversion and recessions: the average annual return is less than half than the full sample return. Lastly, commodities are the only asset class which realized a much better return than the full sample average. This fits the characterization of commodities as 'being late cycle.'

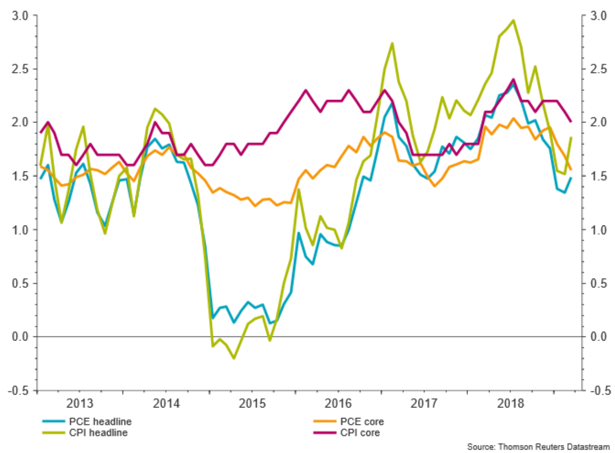
- Still, as we believe it is possible to establish that we are in the later stages of the economic cycle, it could prove prudent to become somewhat less enthusiastic about the return prospects of corporate bonds (as reflected in our multi-asset portfolios) and be a bit more optimistic about those of commodities.

United States

ISM headline surveys are dropping



US core inflation is weakening



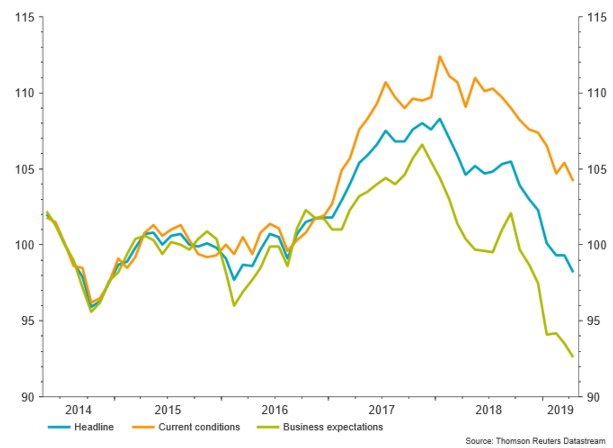
- The US economy expanded robustly in the first quarter, with a growth rate of 3.2%. This is partly due to a rebuilding of inventories and strong government spending. The underlying strength of the economy is therefore probably overstated. Forward-looking indicators have weakened recently. The ISM manufacturing index for April dropped unexpectedly sharply from 55.3 to 52.8, missing an expectation of 55.0. The non-manufacturing index dropped as well, though to a lesser extent from 56.1 to 55.5, also missing the market expectation of 57.

- The labor market showed unexpected strength in April, however. Non-farm payroll growth amounted to 263,000, while the unemployment rate declined from 3.8% to 3.6%, the lowest level since December 1969. Wage growth by contrast remained timid at 3.2% on a yearly basis. It is not an exaggeration to characterize the current state of the US economy as being in some state of 'goldilocks'.

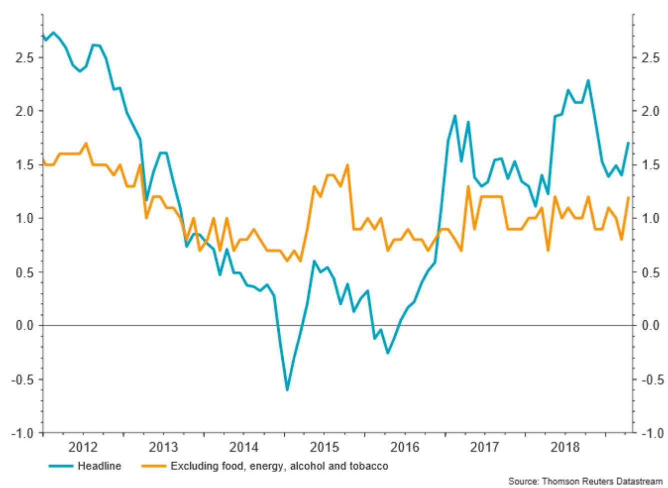
- Inflation remains well below the Fed's 2% target. The central bank's preferred gauge, core PCE (excluding volatile food and energy prices), showed just a 1.6% gain in March. Fed Chairman Jay Powell described this year's drop in inflation as transitory. In an apparent further attempt to bolster inflationary expectations, he stressed the importance of a symmetrical inflation target, which suggests future Fed tolerance for a modest overshooting of the 2.0% target. Notwithstanding these dovish signals, the US administration continues to pressure the Fed for lower rates.

Europe

German producer confidence weakens again in April (2005=100)



Eurozone inflation is accelerating



- After a pause in March at 99.3, the IFO index for the German business climate unexpectedly resumed its decline in April to 98.2. Any mild optimism rising last month has evaporated. The German economy (a third of the Eurozone) narrowly avoided a technical recession in the fourth quarter of last year. Doubts are increasing that the Eurozone's largest economy won't be able to stop the rot. The German government recently lowered its growth estimate this year to a meagre 0.5%.

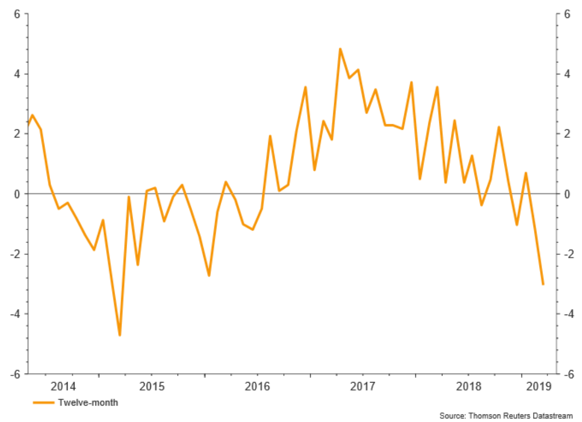
- By contrast, the flash estimate for GDP growth for the whole Eurozone was an unexpectedly positive 0.4% in the first quarter, up from 0.2% in the fourth quarter of 2018 and 0.1% in the third quarter.

- Eurozone headline inflation picked up in April, with a flash estimate of 1.7%, up from 1.4% in March on a yearly basis, mostly driven by energy costs, which rose 5.4%. Core inflation rose from 1.0% to 1.3%. Some caution in interpreting this welcome uptick is warranted, as the relatively late Easter this year distorted prices of holiday-related items such as travel and hotels, with lower prices in March but higher prices in April during the holidays.

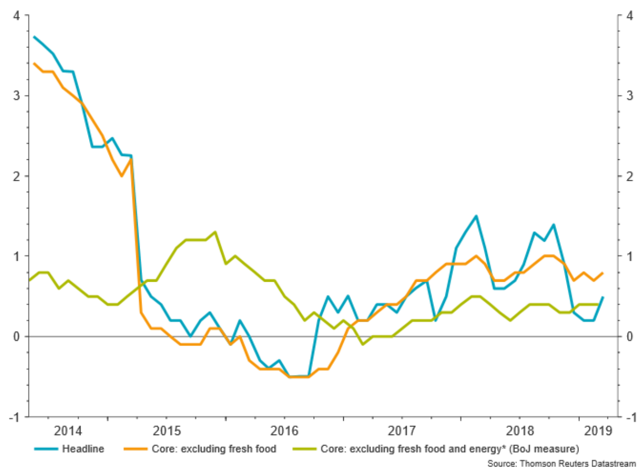
- The uptick in inflation is unlikely to change the forward guidance of the ECB, which is worried about the gloomier economic outlook. It has promised to keep key ECB interest rates at their present levels at least through to the end of 2019. It will provide banks with a round of cheap funding starting from September this year, but has yet to decide what this will look like.

Japan

Surprise drop in industrial output



BoJ's March 'core core' still sideways at 0.4% (YoY)



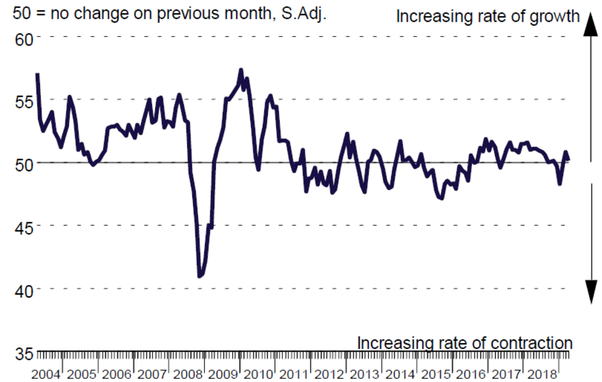
- Japanese industrial output declined unexpectedly in March, as the figures released in April showed, thereby suggesting that the economy has contracted in the first quarter. With growth sputtering, speculation is rising that Prime Minister Shinzo Abe will postpone for the third time the scheduled hike in the VAT from 8 to 10% in October this year.

- In bilateral trade talks, the US is threatening to impose automobile tariffs as high as 25%. These could come as early as 18 May, but will probably be postponed. A US priority is to gain a larger access to the domestic Japanese agricultural markets. The Japanese government is unlikely to grant any concessions on agriculture ahead of Upper House elections scheduled for July. A quick, limited deal doesn't seem likely, increasing the risk that the tensions push the Japanese economy into a technical recession.

- The core-core inflation index excluding both energy and fresh food – the gauge preferred by the Bank of Japan (BoJ) – was again stable in March at 0.4% on a yearly basis, far below the ambitious target of 2.0%. For the third time, the central bank has clarified what it means by an "extended period" in which to keep interest rates low. It has now promised not to hike interest rates until at least Spring 2020. As no-one is expecting a rate hike next year, this move is unlikely to make any difference to the economy. Ironically, the BoJ has adjusted its own projections for inflation to 1.6% for the 2021/22 fiscal year, signaling that it doesn't believe it will be able to reach its target of 2.0% over the medium term.

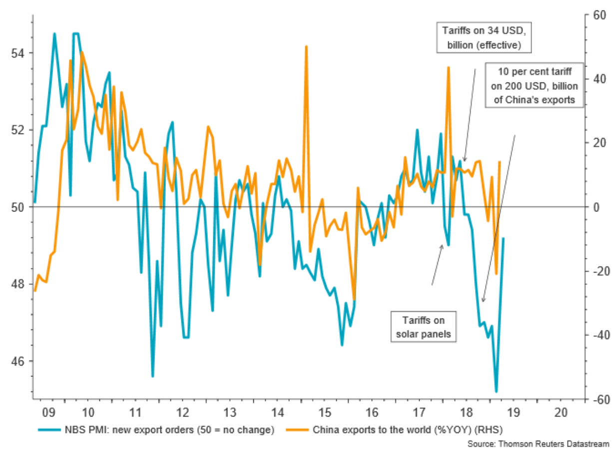
China

Caixin China General Manufacturing PMI easing to 50.2 in April



Sources: IHS Markit, Caixin.

Strong rebound in new export orders, exports recovering



- China's economy showed signs of stabilization by growing at a steady rate of 6.4% in the first quarter. It defied expectations of a further slowdown, with industrial production improving markedly. Moreover, consumer demand appeared to improve. Fixed-asset investment increased as well, as new road, rail and port projects gathered steam.

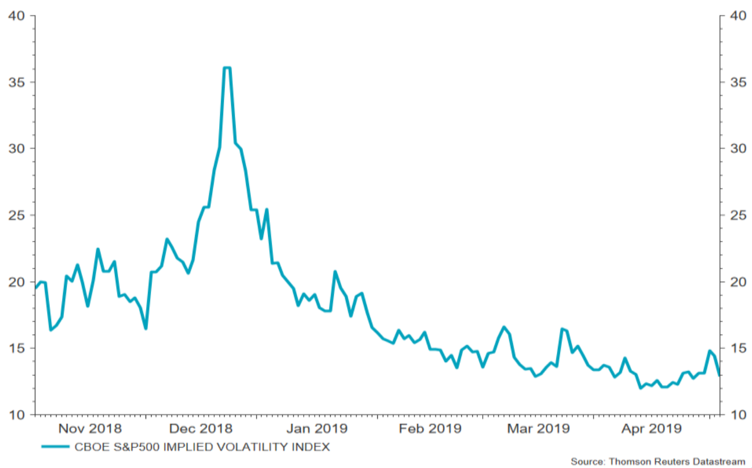
- Signs of stabilization were confirmed by the Caixin General Manufacturing PMI, which pointed to continued growth in April, albeit at a lower level. The export sector showed signs of recovery as well, illustrated by the strong rebound in new export orders.

- All in all, it is probably too early to conclude that a definitive turning point has been reached. More modest stimulus by the Chinese government is to be expected, including a further lowering of the reserve requirement ratio for Chinese banks.

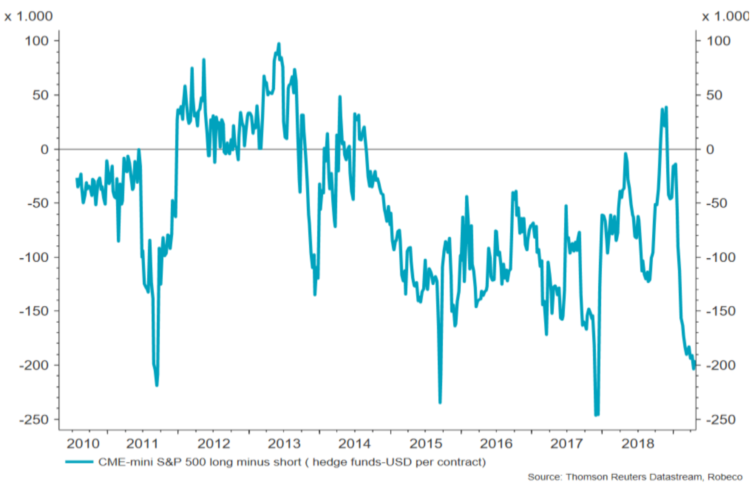
- Earlier signs that the US administration was eager to close a trade deal with China shortly, by dropping some demands, were blown away by President Trump tweeting that he plans to increase a range of tariffs, and even wants impose new tariffs on imports not already covered. This puts pressure on a new round of talks in May. A final trade agreement, which of course cannot be more than a temporary truce while negotiations continue on a host of subjects, will be sealed by a personal handshake between Trump and Chinese President Xi Jinping. It's too early to say whether this is will be in the short term.

Equities (I)

Equity market reflects calm



Smart money, i.e. hedge funds have sizeable net shorts in the S&P 500



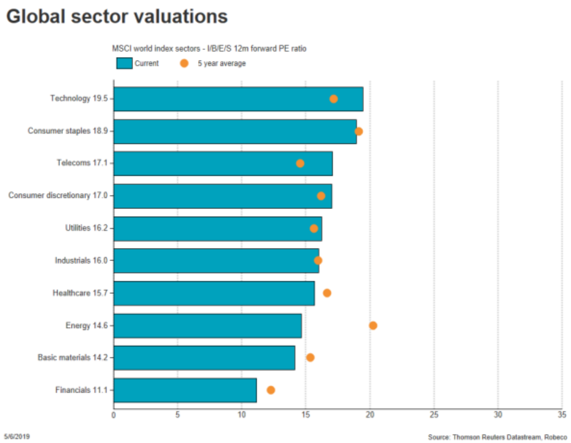
- Is it Goldilocks all over again? Maybe, but rebounding global economic growth, subdued inflation and central banks responding with a unanimous easing bias to this macroeconomic constellation suggest so. Strong business sector productivity gains were seen over Q1 in the US (+3.6% YoY), while China showed signs of stabilization with 6.4% YoY economic growth in Q1. This indicates that the global economy is on a stronger footing than was feared at the end of last year. The Fed signaled its intention to pursue a symmetric inflation target and thereby its willingness to allow an inflation overshoot. Global macroeconomic surprises stayed negative overall, but managed to lift from their March lows. As yield curves steepened again, bearish financial media stories about imminent recession risk largely disappeared.

- As a reflection of the positive sentiment in the markets, the implied market volatility of FX and equity markets has dropped to very low levels, inducing risk parity funds to increase their equity exposure and speculators to extend positions in short volatility funds.

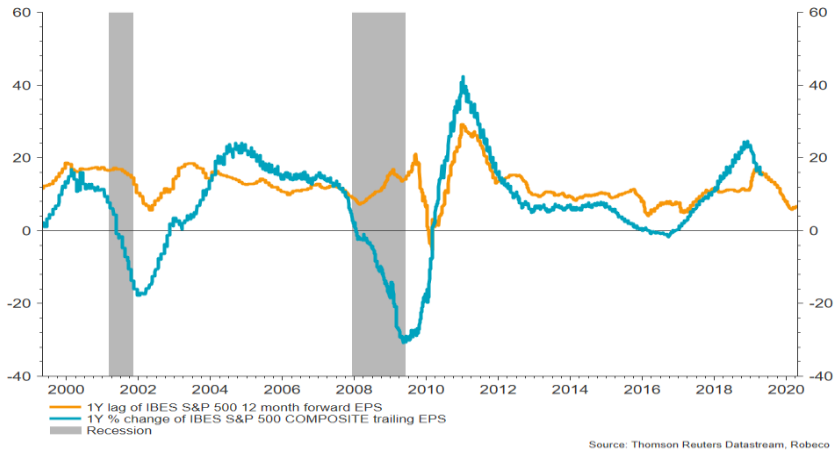
- The Q1 earnings season also helped sentiment, as developed markets solidly beat earnings expectations, with EPS growth remaining in positive territory at around 3% (YoY) for the S&P 500 (around 78% of companies having reported at the time of writing) and 1.7% (YoY) for the Stoxx 600. As a result of positive earnings surprises, global revisions also edged higher, as analysts upgraded forward earnings expectations. Valuations in equities reflect this, with both developed and emerging markets becoming more expensive on metrics such as P/E and CAPE.

Equities (II)

Valuations are looking richer again



EPS growth expectations modestly increase, but the trend is decelerating



- While markets seem to reflect a Goldilocks scenario, the relaxed mood also leaves equities more vulnerable for a game changer. Some market participants are already fully positioned for a negative market surprise. Hedge funds have been standing on the sidelines of this YTD rally and have built a sizeable net short in the S&P 500 instead. A back-test shows that this kind of smart money positioning has preceded a mild correction in the subsequent month two out of three times.

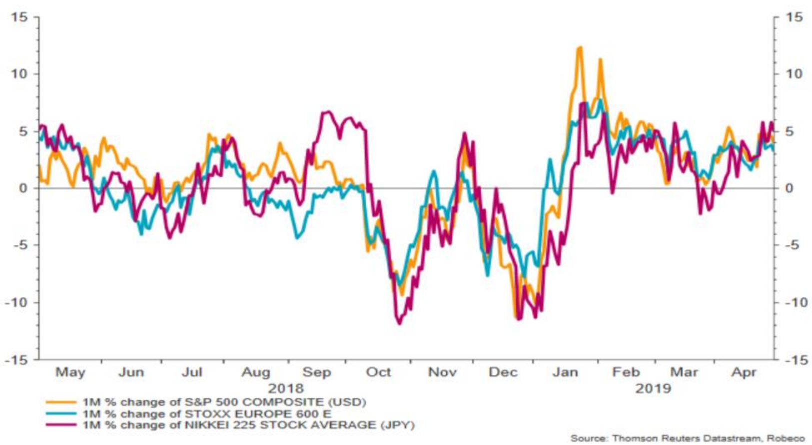
- Some signs are still positive, such as a decline in unit labor costs boding well for profit margin recovery and low immediate recession risk. Equity seasonality has turned negative in May, but fundamentally there is some room for equity markets to continue the upward sloping path.

- A real game changer may have manifested itself in the form of a batch of aggressive tweets from President Trump in early May. He unexpectedly announced plans to raise tariffs on Chinese exports during ongoing negotiations with China. A China-US trade deal is more distant than markets anticipated, while the Fed is potentially set up for a dilemma: give in to Trump's demands and rescue the market some other time, or virtue signal its independence from political pressure.

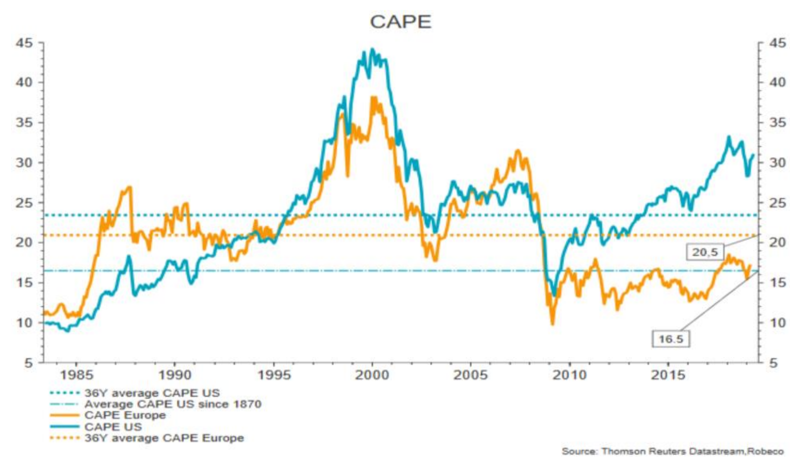
- After the 'Trump tweets', we reduced the weight of developed equities once again. The slight overweight we now have in developed equities is mainly to steer the overall portfolio towards a neutral stance, offsetting the risk in our underweight positions in credit and high yield.

Developed Market Equities

Developed momentum accelerates as earnings season progresses



Further rerating of US equities, Europe joins in



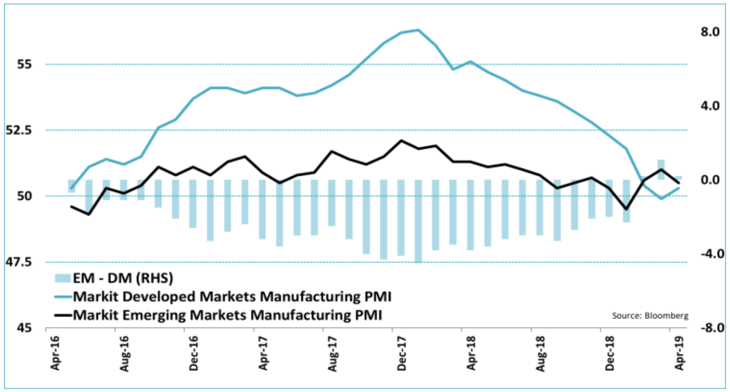
- In April, the developed market equity rally found new fuel to continue one of the strongest YTD rallies in recent history. Comparable + 15% YTD performances in the first half of the year have often, like this one, occurred in a pre-US election year. This time, a promising start to the Q1 earnings season, with earnings numbers overall surprising to the upside, led the market to new highs. While sentiment seemed to improve further, with retail investors becoming more bullish, segments of the professional investor community appear to be still standing on the sidelines.

- Based on monthly momentum of equity returns in local currency, last month saw a notable performance by Japanese equities, generating 5.8%. The S&P 500 added 4.6% in US dollars in April. European equity investors closed the month with a return of 3.9% for the Stoxx 600. Long momentum (12M-1M) signals remain overwhelmingly positive for the US at 7.1%, with a sizeable gap in long momentum opening up between the US and the rest of developed markets since end of March. Long momentum for Europe and Japan remains negative, with Europe showing a return of -2.2% in euros on the 12M-1M signal, while Japanese equities experienced more negative long momentum, with Nikkei 225 stocks down 6.4% in yen on a 12M-1M horizon.

- Equity valuations have increased further as a result of the Fed leaving policy rates unchanged in the medium term, and positive earnings surprises in Q1. The Shiller CAPE for the US rose above 30 again, while European equities also saw a rerating to a cyclically-adjusted PE of 17.7, up 0.5 from March levels.

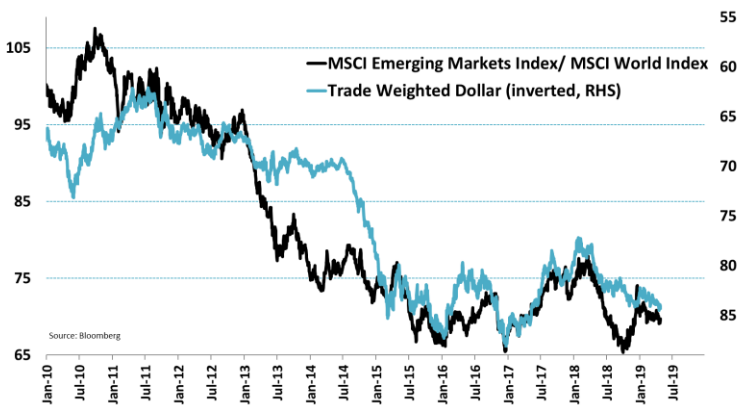
Equities: Emerging vs Developed (I)

Emerging versus developed markets: Manufacturing PMI



Source: Bloomberg & Robeco

Emerging versus developed markets and the trade-weighted dollar



Source: Bloomberg & Robeco

- Emerging market equities realized another positive return last month. The MSCI Emerging Markets Index in euros rose 2.6% in April against a 3.7% rise for the MSCI World index in euros. Just like in March, both emerging and developed market equities were the best-performing asset classes. Hence, the overweight we have in both camps positively contributed to the performance of the multi-asset portfolio. This month, however, we reduced the weight of emerging markets to neutral on potential escalation of trade tensions between the US and China.

- After rising for two consecutive months, the emerging markets Manufacturing PMI fell in April, but remained above 50. It was also the third consecutive month that it remained above the developed markets Manufacturing PMI, albeit modestly. As the chart on the top left confirms, manufacturing momentum remains very modest for now.

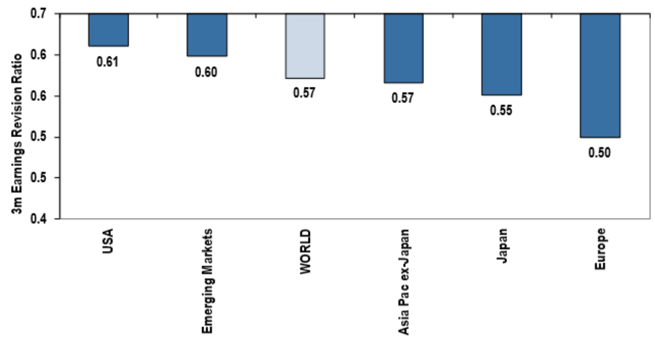
- This is also reflected in a series of alternating macroeconomic data. After strong Chinese economic hard data (GDP growth, industrial production and retail sales all surprised on the upside), the latest Chinese PMI data was below expectations. Singaporean electronic exports collapsed, while South Korea's exports came in better than expected, even though they are still down in a year-on-year basis.

- The recent turmoil surrounding the trade talks between China and US poses a clear risk. At the time of writing, President Trump had tweeted that he would raise tariffs from 10% to 25% on USD 200 billion of Chinese imports, and will look to put tariffs on all other imports as well.

Equities: Emerging versus Developed (II)

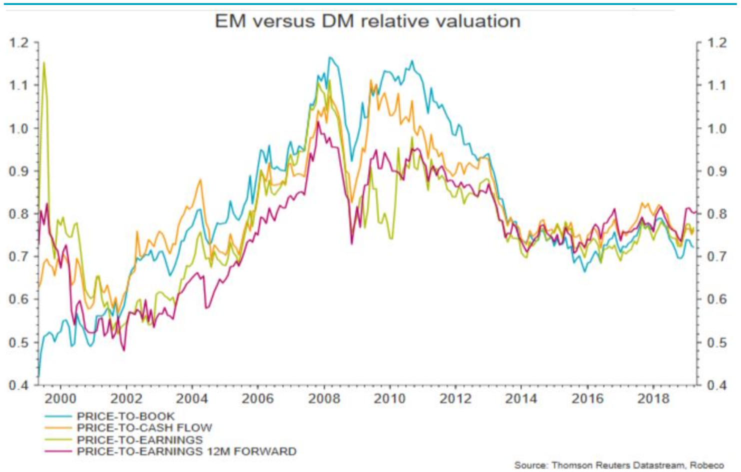
Earnings revisions

Chart 8: Earnings Revision Ratio by Region - Last 3 Months



Source: BofA Merrill Lynch Global Quantitative Strategy, MSCI, IBES

Valuation – the discount is lose to neutral

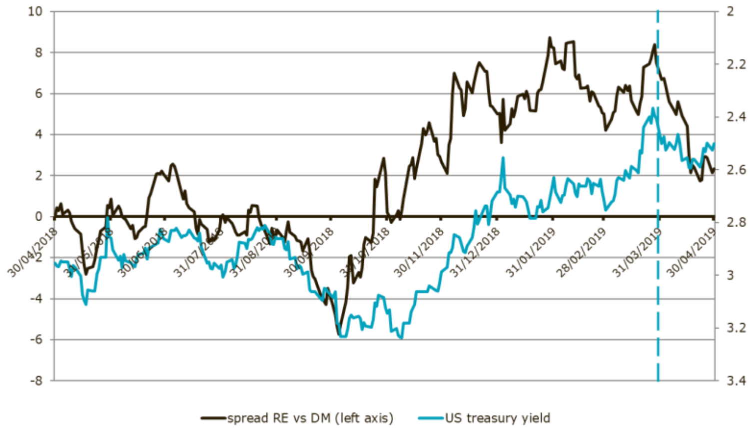


Source: Thomson Reuters Datastream, Robeco

- Since emerging markets remain relatively vulnerable to trade issues, as was again demonstrated in the latest global trade numbers published by the Dutch CPB, and markets were anticipating this, we opt to take a neutral stance on emerging equities for now. That is at least until it becomes clearer what the Trump administration is trying to achieve.
- Stronger-than-expected US GDP growth and the Fed emphasizing that interest rates will stay put for the foreseeable future have pushed the US dollar up, which tends to have a negative effect on emerging market asset prices. To take more positive stance, emerging markets have looked pretty resilient so far, even as the dollar has risen. The renewed trade tensions, however, now distort this picture.
- While not great, emerging market earnings per share growth has held up reasonably well, and earnings revisions have improved on both an absolute and a relative level. Emerging markets have moved up to second place in the ranking, as shown in the chart on the top left, but differences between the regions are small at this point.
- Valuation remains marginally supportive. Relative to developed markets, most valuation measures are at the lower end compared to recent history.

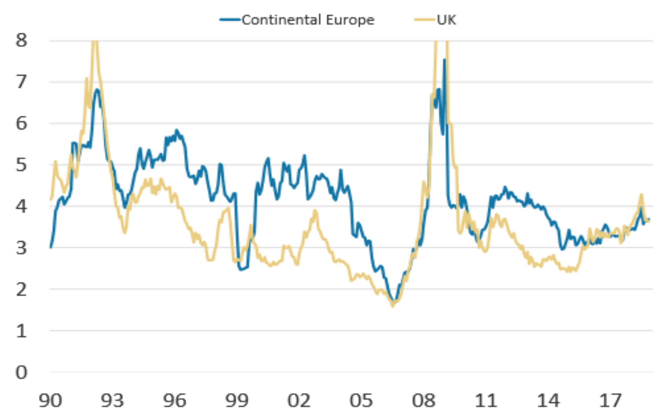
Real estate

The outperformance of real estate was almost erased



Source: Bloomberg, Robeco

Europe: an attractive dividend spread against bond yields



Source: Datastream, Morgan Stanley Research

- The year-to-date outperformance of global real estate disappeared in April, as real estate measured by the S&P Global Developed Property Index (USD) declined 1.4%, while the broad MSCI World index in USD added 3.6%. This meant an underperformance of 4.8% in just one month. It was in fact a reversal of what happened in March, when real estate rallied and equities didn't.

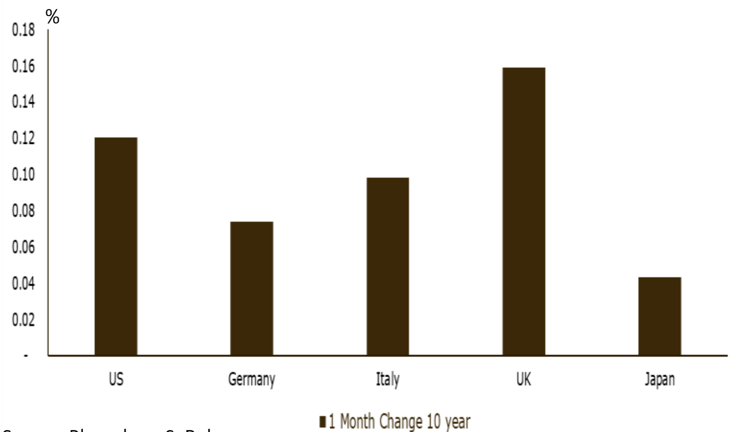
- The low interest rates theme, which provided a strong tailwind in the first months of the year, seems to have disappeared for the moment. After the low in the US Treasury yield of 2.38% at the end of March, the marginal rise of 20 basis points had a huge effect on the relative performance of real estate against equities. Meanwhile, the US housing market produced some mixed figures, although most real estate companies reported first quarter results in line with expectations.

- Despite increasing worries such as the revival of the trade war between the US and China, the global economic outlook isn't that bad. The current 'no-hike' policies of the ECB and the Fed is a positive factor, particularly in Europe, where room for major changes either way in bond yields is limited. Dividends remain firmly above bond yields, even in the UK, where markets are falling and many real estate firms are 'cheap for a reason'. Continental Europe is preferable in that respect.

- We stick to our neutral position of real estate in the portfolios.

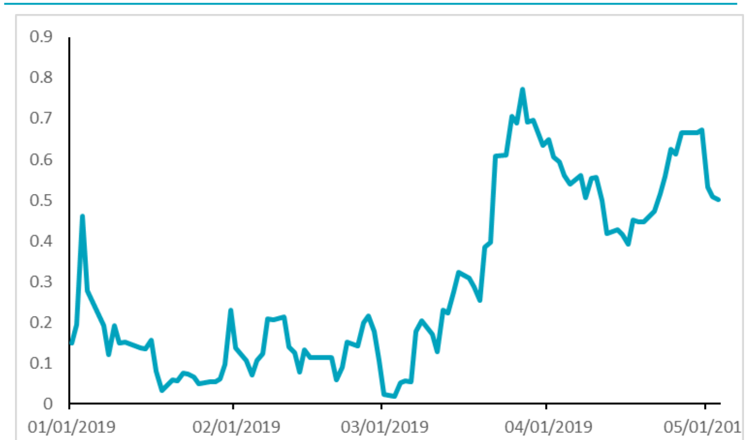
AAA Bonds (I)

April: rates recovered across the board



Source: Bloomberg & Robeco

The probability of a rate cut in 2019



Source : Bloomberg & Robeco

- In April, the general trend for yields was up. This upwards pressure on yields happened in the absence of major triggers. It looks like the bond market was just catching up to the more upbeat stance of the stock market. The upward pressure was felt across the curve, although less so in the two-year part. This is probably due to the dovish pivot of the major central banks in the first quarter of the year.

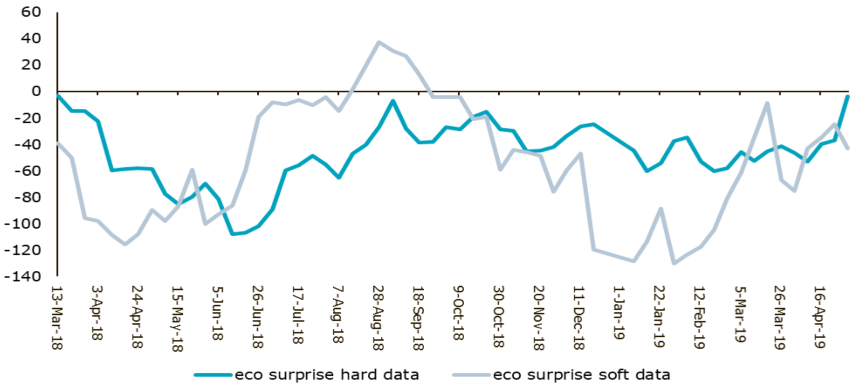
- The market currently attaches a probability of around 50% for a rate cut by the Fed in 2019. However, we continue to think that there will be no rate cuts this year. We think that the Fed's opinion is that policy rates are now at neutral.

- While we think the market is attaching a too-high probability to a rate cut in 2019, we agree that the probabilities for either a hike or cut are asymmetric, and skewed towards a cut. The reason is that several Fed speakers have made the point that it is not that unusual to cut rates at a time that growth is up and around trend.

- This could be done to boost inflation expectations and actually would be in line with the policy objective. Given that on several measures it looks like inflation is either leveling off or even decelerating, the Fed should have enough cover to cut rates if deemed necessary, whatever the reason.

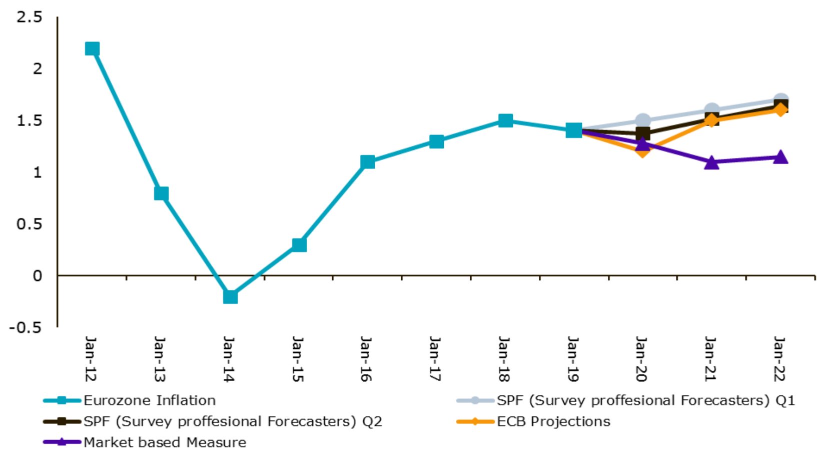
AAA Bonds (II)

Eurozone: hard data is coming in stronger than expected



Source: Bloomberg & Robeco

Market-based inflation expectations remain low for the Eurozone



Source: ECB, Bloomberg & Robeco

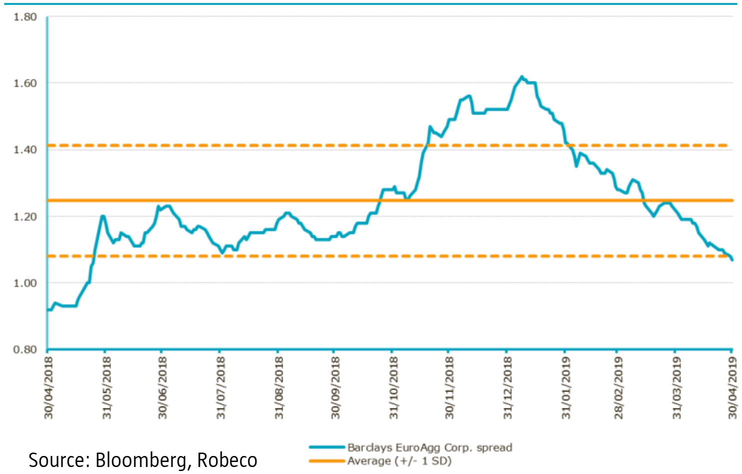
- Meanwhile, after a weak patch, US data is starting to recover. Job and wage data remain strong, retail sales and the US manufacturing PMI have rebounded, and while the non-manufacturing PMI was weaker, it remains firmly above the 50 threshold. In the Eurozone, it looks like we finally got confirmation that the balance is shifting to a rosier growth picture. It's the first time in quite a long time that hard data is coming in better than expected. Unfortunately, the softer data series (surveys) are still disappointing.

- That said, weak inflation is not just a US phenomenon – it has plagued the Eurozone for quite a while. Even the recent rise in oil prices has failed to provide much upward support to the market-based inflation measure of the Eurozone. This measure remains low due to persistent low inflation prints, weak growth and the view that the ECB has very few policy tools left.

- We understand that the market is anticipating a rate cut in the US. We stick with the view that the soft patch is not a precursor for a recession. It also looks like we have finally reached the bottom of the growth slowdown in the Eurozone. What is missing is inflation. However, this enables the central banks to remain cautious, even when growth rebounds. We continue to think that the upwards pressure on yields will build, but this will be a slow process. Therefore we prefer to remain on the sidelines for now.

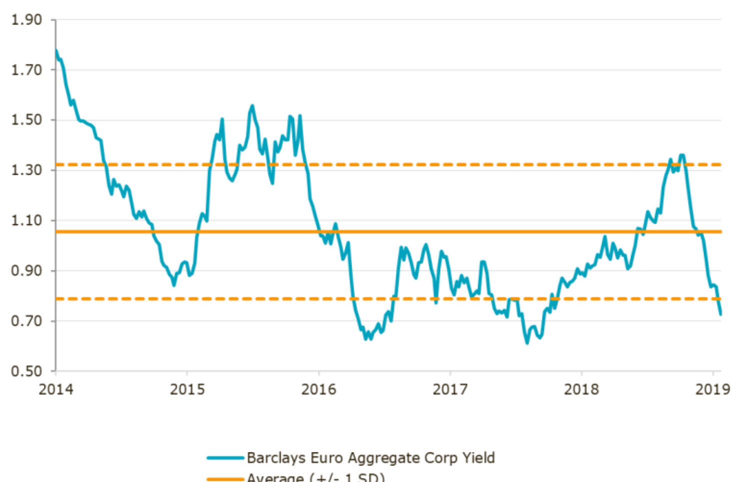
Investment Grade Credits (I)

Straight down: spreads



Source: Bloomberg, Robeco

Yields have declined even more sharply



Source: Bloomberg, Robeco

- European yields and spreads have fallen in one straight line since the start of the year. In April, spreads tightened by another 16 basis points to 1.07. Spreads are back at the level of one year ago, when the termination of the CSPP program had yet to be announced. They are now tipping the lower bound of the average spread of last year minus one standard deviation, indicating that spreads are really low.

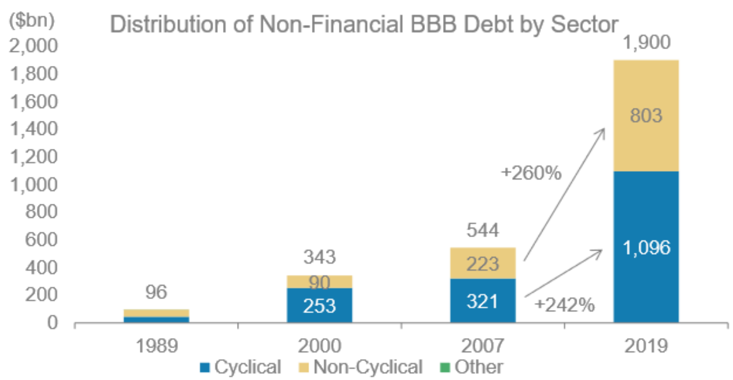
- But now there is no ECB around to consume the relatively high issuances in the primary market. The market just has strong appetite for credits, as this is the asset class still offering a little yield without too much extra risk compared to government bonds. It is a sum of factors that provide the current tailwind: central banks have changed their tone of voice since Q4 last year, and economies are still growing, albeit at a slower pace, but not harmful for corporate profits. The expected defaults are low and currently stand at 0.9%. Although the rating agency Moody's expects the default rate to rise to 1.8%, this is still low in an historical context. In such an environment, credits are an alternative for government bonds and their 0% yield.

- Therefore, yields have declined sharply, and have only been lower at the time the ECB was aggressively buying sovereign bonds in 2016 and introduced the CSPP credit-buying program in the second half of 2017.

- This makes credits more expensive by the week, and raises the question of how much room spreads have to tighten further.

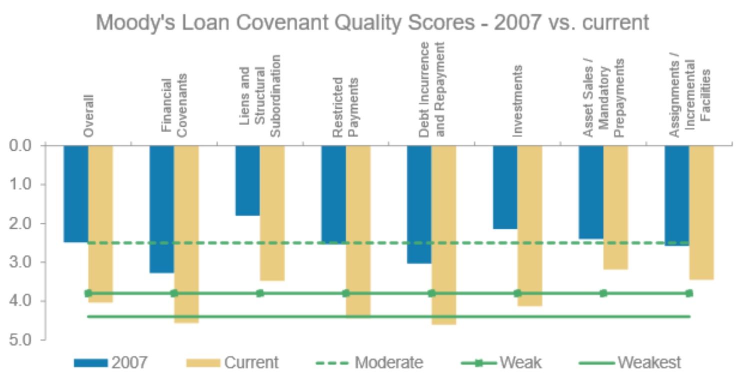
Investment Grade Credits (II)

Growth in the BBB segment



Source: Morgan Stanley Research, FTSE Fixed Income LLC, Bloomberg;

Loan covenant quality is at very low levels



Source: Morgan Stanley Research, Moody's

- Compared to Europe, the spread development in April was less outspoken. Actually, spreads were flat most of the time last month, and closed around 110 basis points. Yields declined at the same speed as in Europe. However, these are significantly higher (3.60% for the index) and far from their 2014 and 2016 lows of 2.80%.

- We have been writing it for some time now that there is a wide range of risks out there, especially for US credits. Leverage, although slightly below peak levels at the moment, is far higher than it was before earlier periods of economic slowdown. Credit quality has deteriorated in this credit cycle. For example, compared to 2007, the BBB segment has exploded, and the covenants in the loan market are at very weak levels, scoring significantly lower than at the dawn of the credit crisis of 2008. That said, defaults in the US will rise only slightly in the coming period.

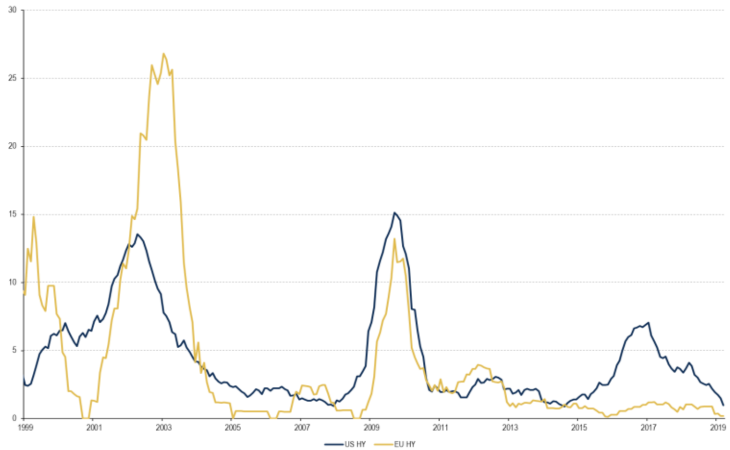
- Credit markets are at least 'stretched' at the moment. But the question is when we are going to see a reversal in the spread's movement. If the current market circumstances continue, with equity markets grinding higher and European government bonds yields at 0%, one could expect spreads to tighten a little more. But most of the compression should be priced in by now, and we think a (mild) widening of spreads is the most likely scenario for the coming period. The default risks may be low, but other risks remain, and the market technicals aren't favorable. Hence, we feel comfortable with an underweight position in credits.

High Yield (I)

High yield – spread

Source: Robeco & Bloomberg

High yield – defaults



Source: BofA Merrill Lynch & Bloomberg

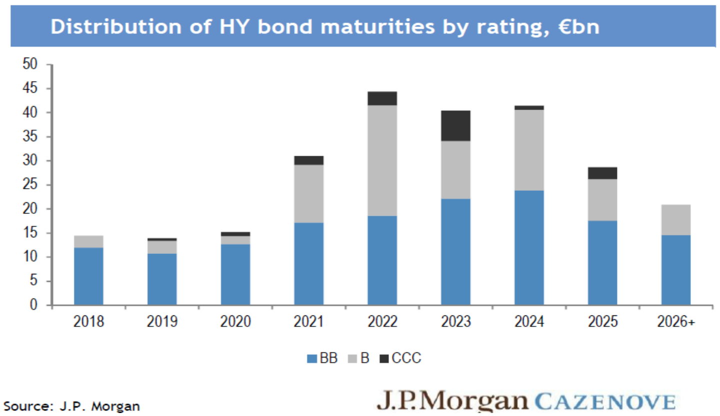
- High yield bonds realized another decent return in April. After rising by 0.5% in March, the asset class added another 0.7% last month. This is nowhere near the returns realized by equities, in which we were overweight in the multi-asset portfolio until very recently, but higher than all other fixed income asset classes. The average spread on global high yield fell 17 basis points to 417.

- As mentioned last month, we don't see much more upside for high yield bonds. As developments have confirmed in recent months, the global economy has entered the later stages of this economic cycle. This is historically a phase in which high yield bonds (and credits) tend to struggle. While we believe a recession could be quite some time away, especially now that central banks have readjusted their policies, spreads tend to start to widen well in advance of recessions.

- That said, a significant widening doesn't look all that likely in the short term either. The stellar drop in bond yields globally has reduced the odds of a leverage-induced default cycle. The default rate in Europe remains very close to zero at 0.18%. In the US, the realized default rate has fallen below the 1% threshold for the first time since 2014. We expect default rates to stay low for the foreseeable future, with interest coverage ratios manageable, but see diminishing room for further improvement. Obviously a short-term shock like a renewed escalation of the trade dispute between China and the US could lead to significant spread widening. The odds of this happening increased recently.

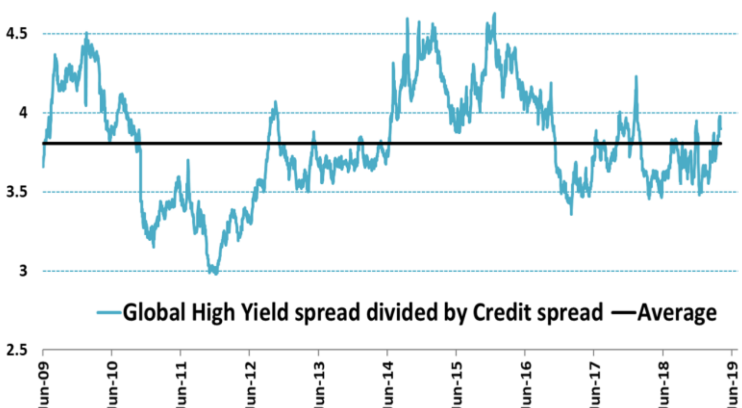
High Yield (II)

High yield – EBITDA



Source: J.P. Morgan

High yield – relative valuation versus equities

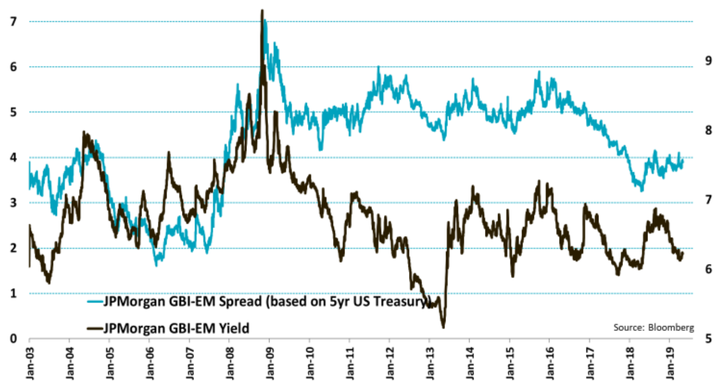


Source: Bloomberg & Robeco

- In addition, the maturity wall looks manageable, as demand for high yield bonds remains firm, giving companies enough opportunities to roll over debt.
- The earnings outlook, however, is looking far less impressive. The unadjusted EBITDA growth of high yield companies has turned negative for the first time since 2016. While we expect a general improvement in earnings growth later this year, as the global economy marginally recovers from the slowdown in the final quarters of last year, investors are likely to scrutinize high yield earnings growth going forward. The slowdown in earnings growth is being accompanied by an increase in downgrades.
- Compared to other risky assets, high yield bonds are expensive. This is especially the case in Europe, where the gap between the earnings yield on Eurozone stocks and the yield to maturity on Eurozone high yield bonds has once again increased. Like credits, average spread levels remain below average.
- We remain underweight high yield bonds. The asset class will continue to perform if the upbeat sentiment on financial markets continues, but we expect other (risky) asset classes to outperform. Historically, spreads have started to widen well in advance of the next downturn. Together with the low level of yield, and the fact that default rates are zero or close to zero, this reduces the upside for global high yield.

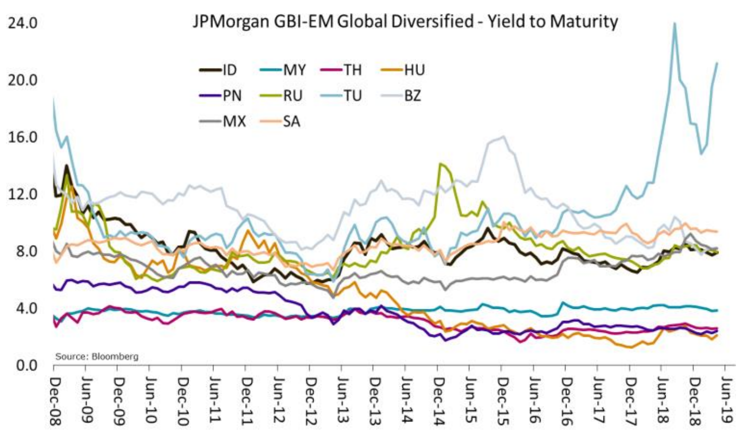
Emerging Market Debt (I)

Emerging market debt in local currency – spread and yield



Source: Bloomberg, Robeco

Yield to maturity



Source: Robeco

- Emerging market debt in local currency fell 0.2% in April, underperforming high yield bonds. Turkey took center stage again as its central bank is in a continuous fight with markets to keep bond yields and the currency in check.

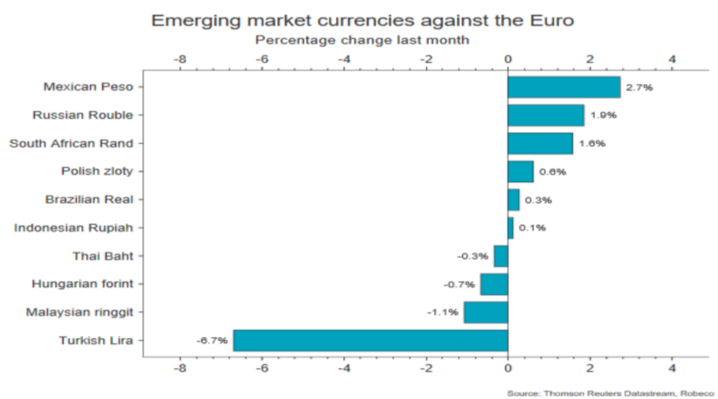
- Both the yield to maturity as the spread relative to the US 5-year Treasury yield were little changed in April. While this may sound positive, given the increased turmoil surrounding Turkey, it was actually less so, taking into account that in developed markets both spreads and yields fell.

- As emphasized in recent months, a renewed escalation of risk can not be ruled out for Turkey, and this is one of the reasons for not going overweight on emerging market debt. Ever since the Turkish elections, in which Turkey basically prevented (overseas) market participants from shorting the Turkish lira, things have looked shaky at best. The central bank has to come up with a broad tool box to keep the lira from falling, and one has to acknowledge that a new rout in the Turkish currency could be imminent. Bond yields also remain very elevated, as can be seen in the chart on the top left. This has not only to do with the currently elevated risk level, but also from the stubbornly high inflation as a result of the currency collapse in the middle of last year.

- Given current macroeconomic conditions, the specific nature of Turkey's issues, as well as its geographical location, we do tend to believe that Turkey represents a relative idiosyncratic risk. However, this could **>>**

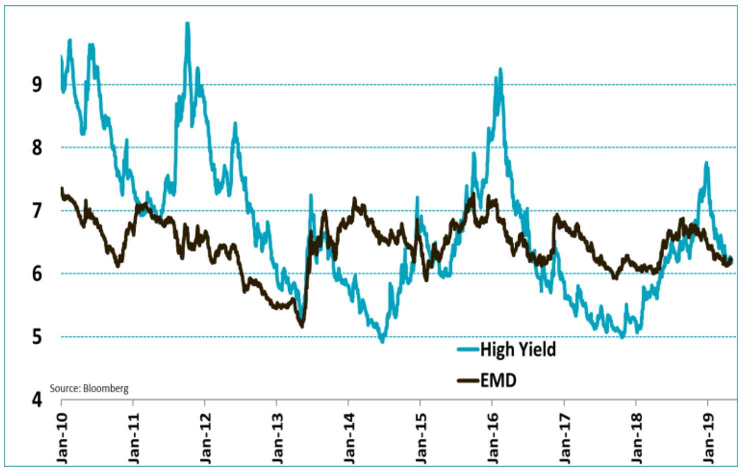
Emerging Market Debt (II)

Emerging Currencies



Source: Thomson Reuters Datastream, Robeco

Valuation: EMD v High Yield



Source: Bloomberg, Robeco

- of course change, for example through spillovers to Eastern European markets, but especially if overall sentiment turns sour. For now, we estimate the odds of this happening as being not that high.

- The chart on the top left shows that, contrary to the Turkish lira, a number of major emerging currencies have strengthened against the euro. This development fits our assumption that on an aggregated level, emerging currencies offer some value following their massive slide in recent years. An improving relative economic outlook could unlock this value as the year progresses.

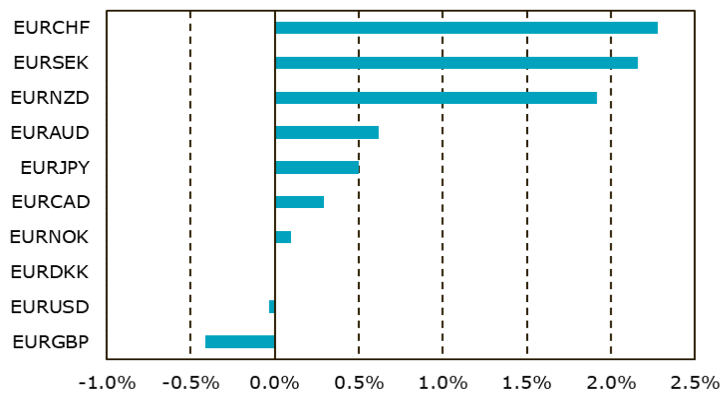
- That said, a new escalation of the trade war between China and US will likely hurt all risky assets, including emerging market debt. At the time of writing, President Trump had tweeted that he will raise tariffs on USD 200 billion of Chinese imports, and will look to put tariffs on other imports as well. It is difficult to judge at this point what this means going forward, but it is clear that risks have increased.

- Valuation remains marginally attractive. While much riskier, we believe the risk/return characteristics for local currency emerging market debt remain more favorable than for Eurozone government bonds. The same holds for European corporates, where we believe we have seen most of the credit spread tightening.

- We remain neutral on local currency emerging market debt.

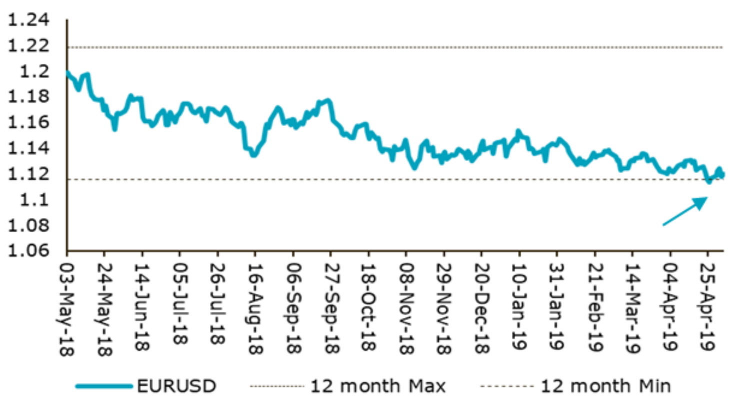
FX (I)

G-10 currencies: sterling was the strongest in April



Source: Bloomberg, Robeco

In April, several crosses broke well-established ranges



Source :Bloomberg, Robeco

- Sterling rose against the euro in April. The postponement of Brexit temporarily removed a lot of uncertainty, which benefitted the currency. The fact remains that it is still very unclear what the future relationship between the Eurozone and the UK will ultimately look like.

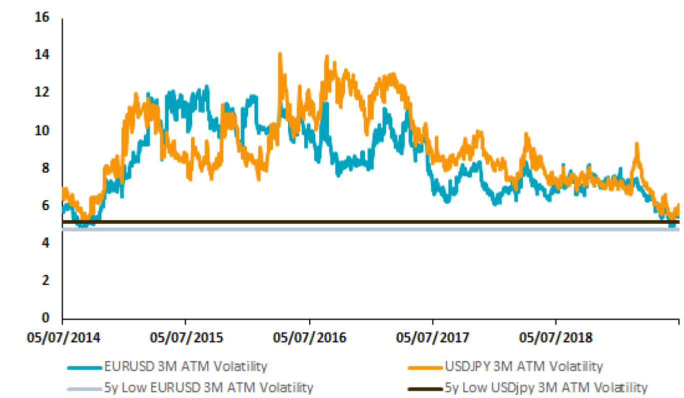
- The biggest losers within G-10 were a commodity currency (New Zealand dollar), a safe haven currency (Swiss franc) and a European cyclical currency (Swedish krona). We struggle to explain the weakness of the Swiss franc, as nothing much has changed; it just remains the cheapest funding currency in G-10. The common driver for the weakness in the SEK and NZD is that the central banks in both countries seem to have moved to running an explicit easing policy, which is negative for their respective currencies.

- After a quite period in currency markets in which currency volatility was very subdued, things suddenly changed. Several currencies broke their well-established ranges against the dollar. The EUR/USD cross hit a new 12-month low in April, which means that we are back at levels we haven't seen for almost two years. The breakout was quickly undone the following day. Pressures remain towards the low end of the range.

- The strength of the US dollar was not what we have been looking for – we were expecting a less dollar-friendly environment. Our base case is that the growth gap between the US and the rest of the world would compress as the effect of the tax cuts started to wear off.

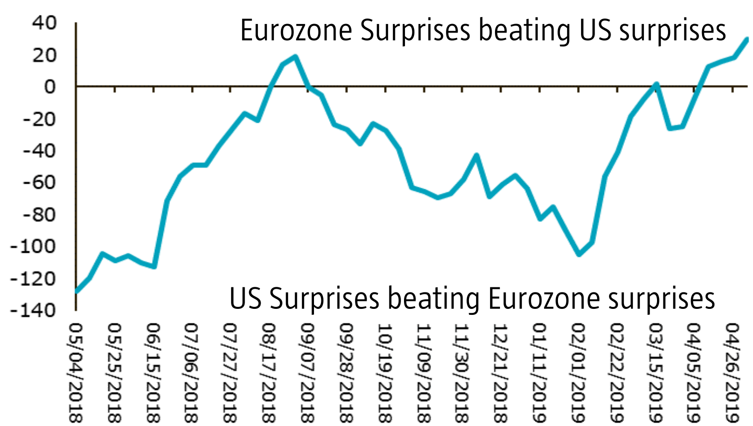
FX (II)

In April, the volatility of several crosses reached a 5-year low



Source: Bloomberg & Robeco

Eurozone surprises are finally beating US surprises… but will it last?



Source: Bloomberg & Robeco

- We saw this starting to play out as US data deteriorated. Things evolved quickly, however. The recovery in the rest of the world has indeed taken hold, but the US seems to have already shaken off the weakness, and is recovering alongside it as well. This prevents the expected monetary and growth compression to play out, and has supported the US dollar. In April, the US was amongst the strongest currencies in G-10. It only marginally lost out the top spot to sterling, which benefitted from a temporary relief of Brexit fears.

- The US dollar currently still has a lot going for it and does better on most metrics (growth, yields, inflation) than most of its peers. Its Achilles heel remains a dovish Fed, which is one of the few major central banks that has the ability to ease. The Bank of Japan (BoJ) currently is unwilling to change the status quo, and the levers left for the ECB to use look limited. This limited ability to ease for the BoJ and ECB has been fully priced in by the market.

- The Fed for now has communicated that it prefers to remain patient. Given the low inflation, the upcoming policy rethink by the Fed in June might trigger a different policy stance. This risk will continue to be on the market's mind. As the expectations for the Eurozone are very low, and if the data finally starts to turn, expectations will need to be repriced, which we think will benefit the euro. For now, the episode of US dollar strength seems not to be over. We continue to have no active currency positions in the portfolio currently.

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