

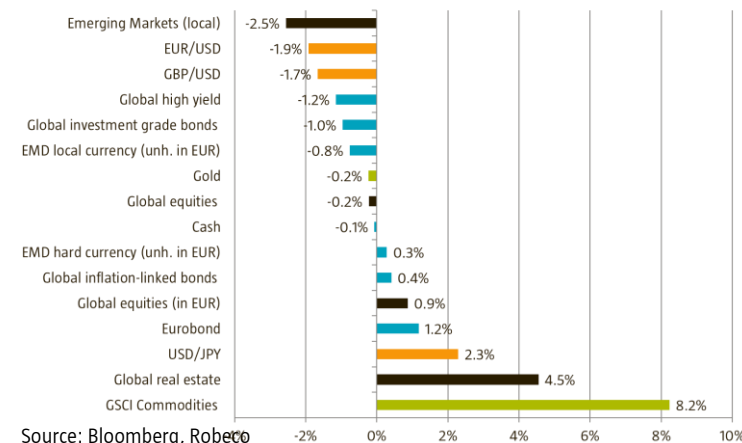
Multi-asset markets outlook

For professional users

May 2018

General overview

A mixed picture



May the force be with us!

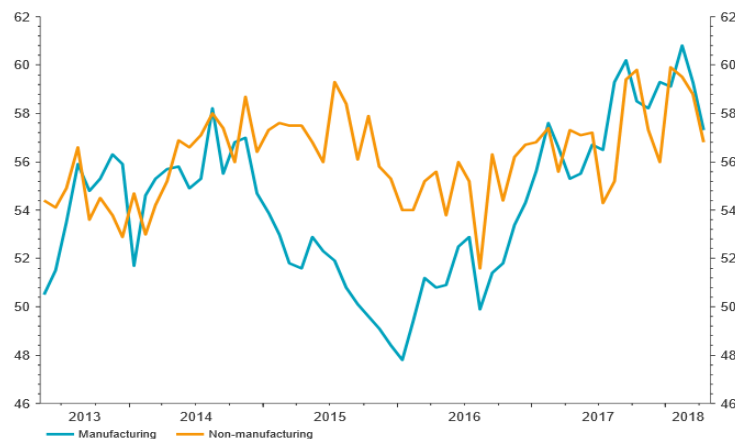
	Portfolio	BM	active	previous
Equities Developed Markets	29.5%	25.0%	4.5%	1.5%
Equities Emerging Markets	3.5%	5.0%	-1.5%	-1.5%
Real Estate Equities	5.0%	5.0%		
Commodities	5.0%	5.0%		
Core Gov Bonds 1-10	17.5%	20.0%	-2.5%	-2.5%
Core Gov Bonds 10+	6.90%	7.5%	-0.6%	-0.6%
Investment Grade Corp Bonds	23.5%	20.0%	3.5%	3.5%
High Yield Corp Bonds	1.0%	5.0%	-4.0%	-4.0%
Emerging Market Bonds LC	5.0%	5.0%		2.0%
Cash	3.10%	2.5%	0.6%	1.6%
EUR/USD	-2.000%	0.0%	-2.0%	3.5%
EUR/JPY	0.0%	0.0%		-2.5%
EUR/GBP	2.0%	0.0%	2.0%	
EUR CASH	0.0%	0.0%		-1.0%

- > There are a couple of themes that are playing a role in financial markets, with the US bond market currently probably the most dominant one. US Treasury yields have been flirting with the 3% level, and this has created some nervousness in bonds, equities and currencies alike. The trend of higher yields is easy to explain: tight labor markets, higher short-term rates, increased inflation expectations, the Fed slowly divesting, rising currency hedging costs, and tax cuts that are funded by issuing more debt. More supply, less demand: go figure what will happen to the price. The nervousness concerning the 3% level is much less logical: 3% has never been a significant level in the past (except for it being extremely low), and there is no golden economic law that says that it should be this time around. We advise investors to walk on, as there is nothing to see here folks, except for the fact that if investors all think there is something to see here, it may take a bit more time to get things moving again.

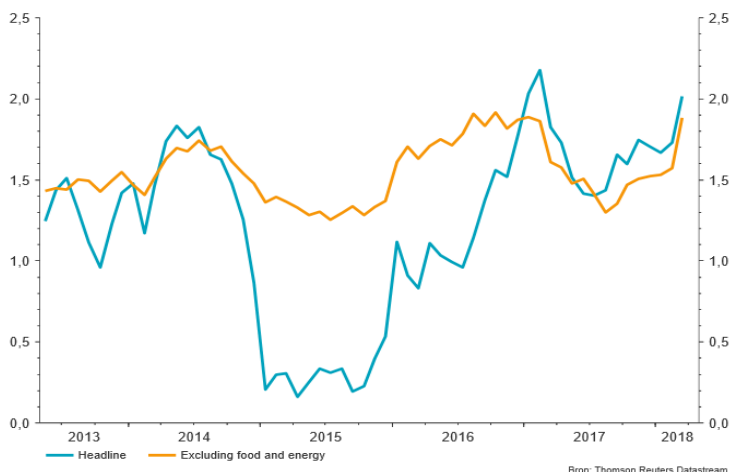
- > What will help? Ongoing steady growth across the world, strong earnings data in the US (Q1 earnings up by more than 20% so far), and a bit less trade-war rhetoric from the current guy living in the White House. So far, Trump seems to be sticking to his plan to put the US first at the expense of the others, but who knows? We think that (earnings) growth will ultimately resurface as the main driver for stocks, which is why we have moved to an overweight position in equities again. At the same time, we have cut our currency positions, as the weakening trend of the US dollar has now clearly been broken.

> United States

ISM manufacturing and non-manufacturing further weaken



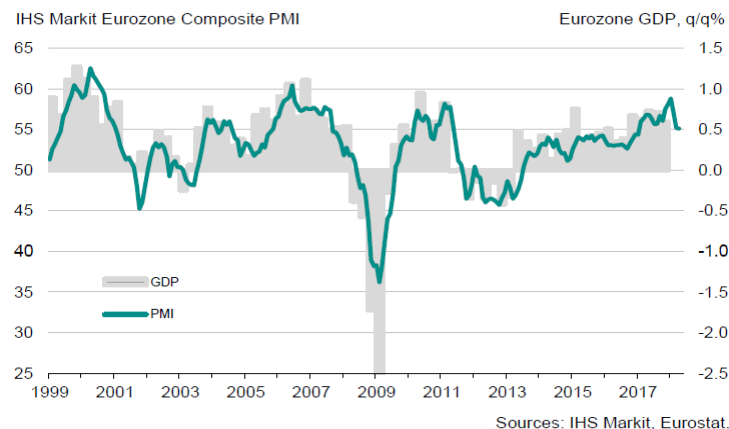
The headline inflation measure preferred by the Fed (PCE) hits 2.0%



- > Both the US manufacturing and the non-manufacturing ISM readings fell in April, though still remaining solidly in expansion territory (far above the neutral level of 50). Factors dampening sentiment were uncertainty about the impact of tariffs, the tightening labor market and the rise in input costs. The impact of the unfunded tax cuts are not yet visible in the economic data, but we expect the pro-cyclical policy mix to make itself clearly felt in the coming quarters.
- > The US president has given Europe an extra month to come up with concessions to avoid the punitive tariffs on aluminum and steel. The EU refuses to negotiate under the threat of sanctions, and seems to harbor little illusion that a trade war can be avoided.
- > The Chinese government has issued a similar reaction to the USD 150 billion tariffs threat: "If they pull out a gun and point it at us, then they can finish their tea and leave." The US has demanded that China reduces the bilateral trade deficit by a drastic USD 200 billion by 2020 from USD 337 billion in 2017. Moreover, it wants China to eliminate all subsidies linked to the "Made in China 2025" plan, striving for technological leadership in key sectors like robotics. As the US agenda apparently is aimed at slowing down China's inevitable economic and technological ascent, a quick compromise seems unlikely.
- > With inflation hitting 2.0%, the Fed introduced the word 'symmetric' in its statement, signaling that 2.0% is not a ceiling. Nevertheless, another modest June hike by 25 basis points is clearly on the cards.

> Europe

Unimpressive PMI figure for April



Sharp decline in core inflation complicates ECB's job



- > The Markit Eurozone Composite PMI disappointedly failed to rebound in April, now that the distorting effects of the unusual winter weather are fading from the economic data, raising skepticism about the underlying strength of the Eurozone economy. Nevertheless, given benign economic developments in China and the US, we expect the Eurozone to continue to grow at a reasonable pace.
- > The direct economic impact of escalating trade tensions with the US for the short term are probably limited, though they can damage producer confidence and discourage long-term investment. If retaliatory tariffs by the EU as an answer to US steel and aluminum tariffs do materialize, they will probably provoke additional US tariffs targeted on the German car industry.
- > The inflation figures for April were very tame, with core inflation diving towards 0.7% and the headline figure declining to 1.2%. Given these developments, the likelihood that the ECB will terminate its bond-buying program in September is diminishing. Instead, it will probably lower its monthly buying target and extend the program towards December. A first rate hike remains a long way off.
- > The UK government is struggling to formulate a credible solution to the open Irish border problem, for which the EU has set a deadline of its regular European Council Meeting on June 28-29. Failing to reach a solution threatens a complete breakdown of negotiations with the EU, raising the specter of an economically disastrous hard Brexit.

> Japan

Japan's 2.0% inflation target remains elusive, even in 2020

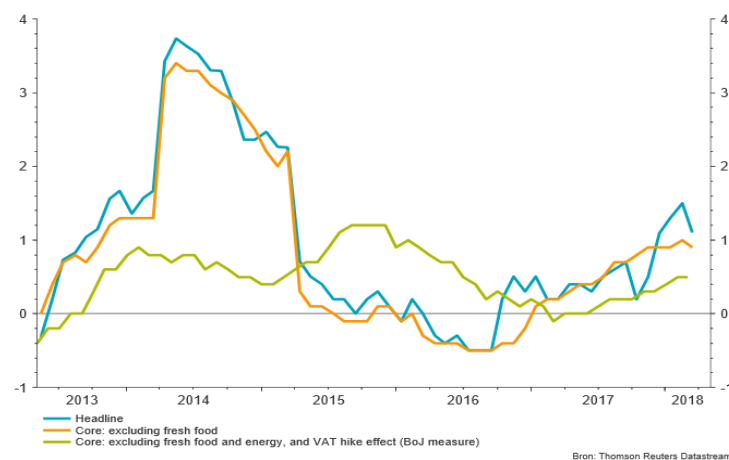
(Appendix)

Forecasts of the Majority of Policy Board Members

	Real GDP	CPI (all items less fresh food)	Excluding the effects of the consumption tax hike
			y/y % chg
Fiscal 2017	+1.8 to +1.9 [+1.9]	+0.7	
Forecasts made in January 2018	+1.8 to +2.0 [+1.9]	+0.7 to +1.0 [+0.8]	
Fiscal 2018	+1.4 to +1.7 [+1.6]	+1.2 to +1.3 [+1.3]	
Forecasts made in January 2018	+1.3 to +1.5 [+1.4]	+1.3 to +1.6 [+1.4]	
Fiscal 2019	+0.7 to +0.9 [+0.8]	+2.0 to +2.3 [+2.3]	+1.5 to +1.8 [+1.8]
Forecasts made in January 2018	+0.7 to +0.9 [+0.7]	+2.0 to +2.5 [+2.3]	+1.5 to +2.0 [+1.8]
Fiscal 2020	+0.6 to +1.0 [+0.8]	+2.0 to +2.3 [+2.3]	+1.5 to +1.8 [+1.8]

Source: Bank of Japan

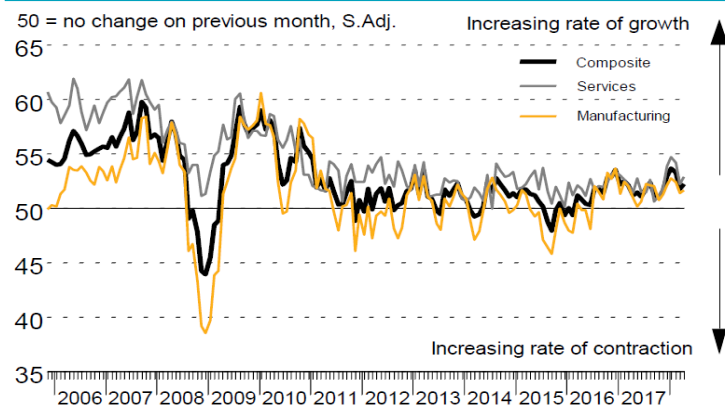
Japan's inflation remains tame



- > The rise in the price of oil due to geopolitical tensions, and trade tensions with the US, undermined Japanese producer confidence, though the domestic economy continues to do well.
- > The US president has suggested a willingness to re-enter the earlier dismissed Trans-Pacific Partnership (TPP) after all, but only after getting an offer he couldn't refuse. Understandably wary of Trump's extreme fickleness, Kazuyoshi Umemoto, Japan's chief TPP negotiator, reacted by saying: "In practical terms, as a negotiator, to have a third TPP – I don't think we'll be able to do that in the near future."
- > Core inflation in Japan declined in March from 1.0% towards 0.9%. The inflation indicator preferred by the Bank of Japan (the so-called 'core core') was stable at 0.5%. Headline inflation declined sharply to 1.1%. The rise in the yen is one factor keeping inflation low. Ironically, rising trade tensions with the US lead to an appreciating yen, dampening inflationary pressures, as the yen is a traditional safe haven.
- > The BoJ kept its policies unchanged, fixing the 10-year yield at 0.0% and the short-term interest rate at -0.1%. One of the nine members pleaded for more stimulus. The BoJ kept its inflation expectations roughly unchanged, but unexpectedly dropped the timing of when it expected to reach its 2.0% target (around fiscal year 2019). Since 2013, the central bank has changed the timing six times to the detriment of its credibility, and in what could be seen as a sign of increasing desperation, it refuses to commit itself to a timeframe from now on.

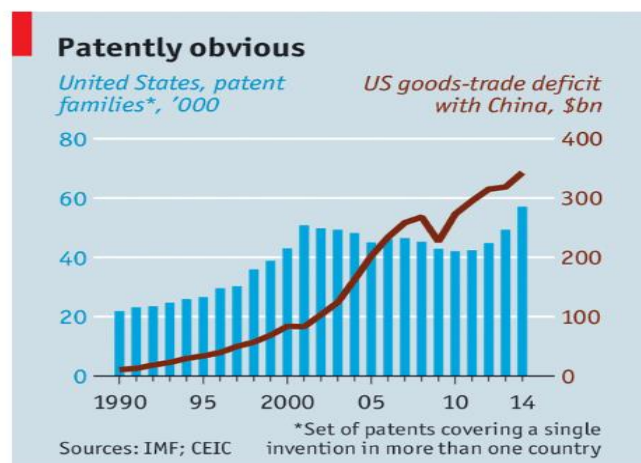
> China

Unexpected rebound in April's Caixin China Composite PMI



Sources: IHS Markit, Caixin.

China's rise does not seem to hurt innovation in the US

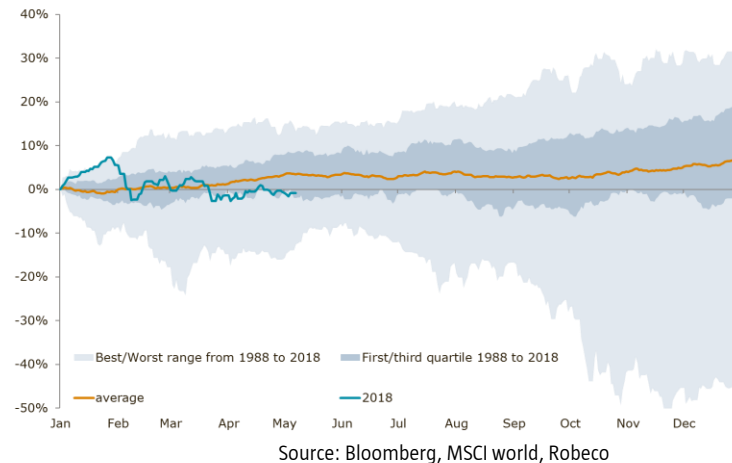


Economist.com

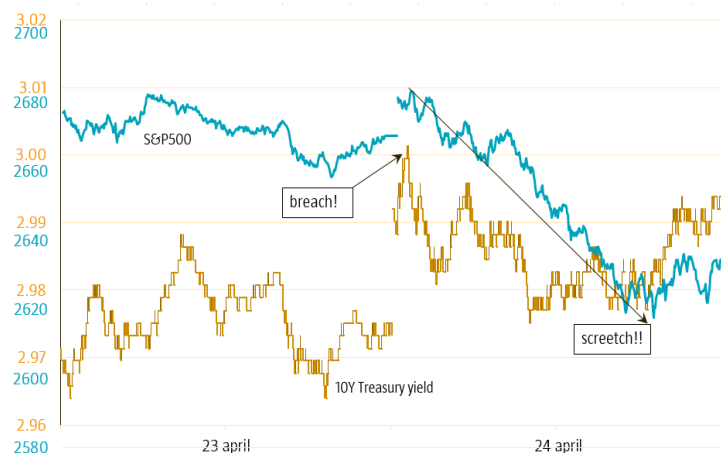
- > The Caixin China Composite PMI, which covers both the manufacturing and the services sector, unexpectedly rose in April from 51.8 to 52.3. Though unimpressive, this indicator suggests that economic growth is stable.
- > The Chinese authorities reported relatively strong first-quarter growth of 6.8%. However, they almost simultaneously lowered the reserve requirement ratio for banks, which in effect is a monetary easing measure, suggesting they have some doubts about the growth momentum. Market interest rates have come down as a consequence of this measure.
- > The IMF recently concluded that Chinese competition has not been detrimental to research and development in the US. Between 2010 and 2014, high-quality patents granted to American companies have risen markedly, while the bilateral trade deficit has risen at the same time. This fact undermines the rationale for US punitive tariffs in an attempt to curb the technological ascent of China. This does not of course rule out a further escalation of the Sino-US trade tensions, since at least part of the current US administration will not be satisfied with some superficial face-saving concessions, fearing Chinese world domination in key technological sectors.
- > Consequently, risks of a prolonged trade war remain high, with detrimental economic effects that are difficult to quantify. Global supply chains could be damaged markedly and confidence could suffer.

> Equities (I)

Drifting sideways...



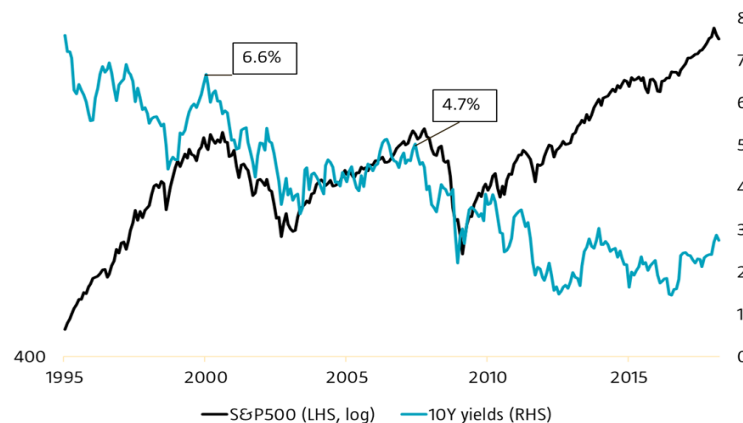
The 3% level acted as the straw that broke the S&P's back



- > The talk of the town in financial markets this month? It's not Trump, not Korea, not trade wars, not even earnings. It's not that these topics are not being discussed – far from it – but to say that they have been the leading themes in the market this month is overdoing it. There is clearly a case of Trump fatigue in the market, with stocks no longer reacting to his latest tweet as they used to do. As for earnings, the US numbers are above excellent, but a substantial part of that is linked to the changes in the US tax system, and it has failed to generally inspire US stocks. No, the real theme of the month is the US bond market, and to be more specific, the 3% yield in 10-year Treasuries. From Bloomberg to CNBC, from the Financial Times to the Economist: every self-respecting news outlet has been reporting on the news that 10-year yields have breached the 3% level for the first time since early 2014. Lo and behold, almost as soon as yields moved above the magical 3% level on April 24, US stocks started to move lower, ultimately surrendering 1.7% from the intraday peak on the first day.
- > So, is 3% indeed as important as some people claim? If we restrict ourselves to an historic assessment, the answer seems to be mostly 'no'. Since 1990, Treasuries have breached the 3% level to the upside on only four occasions, with stocks on average moving 6% higher in the two months that followed. However, this in itself is a fairly meaningless observation: not only is the sample size way too low to draw a strong conclusion, but more importantly, in two of these cases, US Treasuries dropped back below 3% within a week, trending lower after that. So far, Treasuries seem to have stuck to this script this time round as well.

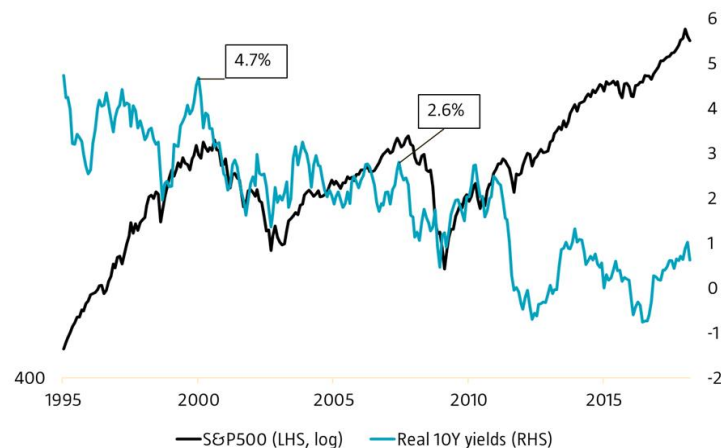
> Equities (II)

Back in the day, nominal yields north of 3% used to be the norm



Source: Bloomberg, Robeco

Real yields were clearly higher back in 2000 and 2008

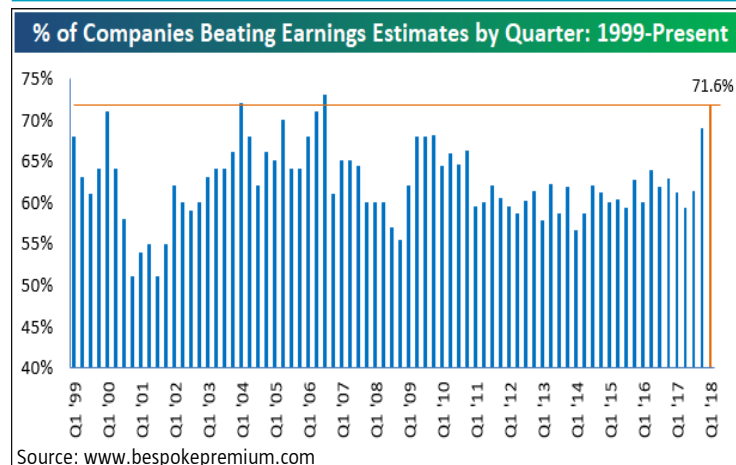


Source: Bloomberg, Robeco

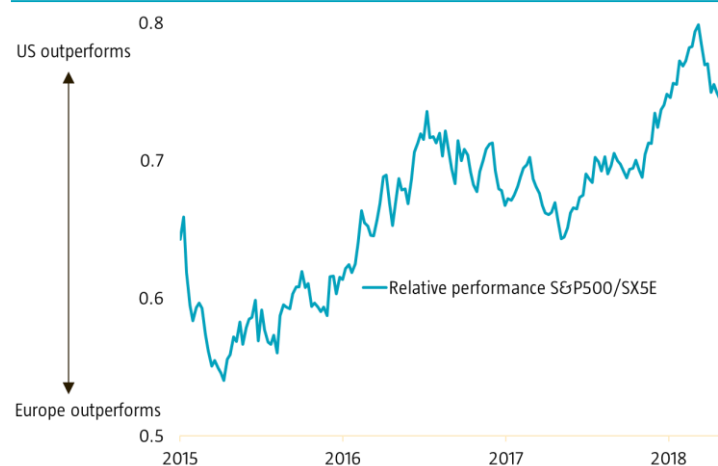
- > Another way to look at the recent past for guidance would be to see what level Treasury yields stood at when the rally of stocks stalled. In the period 1998-2000, US 10-year yields rose from a starting point of somewhat over 4% to a level north of 6% before stocks buckled. In 2008, yields had been moving in a trading range of 4.5-5.0% when the correction in stocks began in earnest. Back in those days, 3% was considered to be an unattainably low level, and certainly not a barrier for stocks.
- > One might think that inflation was much more prominent during those periods, pushing nominal yields higher as a result. This turns out to be wrong: in both previous cases, core inflation fluctuated within a 2.0-2.5% bandwidth, while core inflation currently stands at 2.1%. The US stock market – and in fact the US economy at large – continued to perform pretty strongly, with a real rate (the nominal rate minus core inflation) higher than 4% in 2000 and above 2% in 2008; the current real rate is still below 1%. In general, the level of real yields that an economy is able to cope with depends on a lot of variables, including the leverage of companies, their refinancing needs for the year(s) ahead, the phase in the business cycle and – most importantly – on overall sentiment. Based on these variables it is clear that it is near to impossible to tell beforehand when bond yields will start to hurt for real. The odds of this happening at exactly 3% are of course quite small. As such, we seem to be witnessing a classic case of round numbers: people generally attach too much value to the value of 3%, or 10,000, or 60.

> Equities (III)

Earnings are better than expected



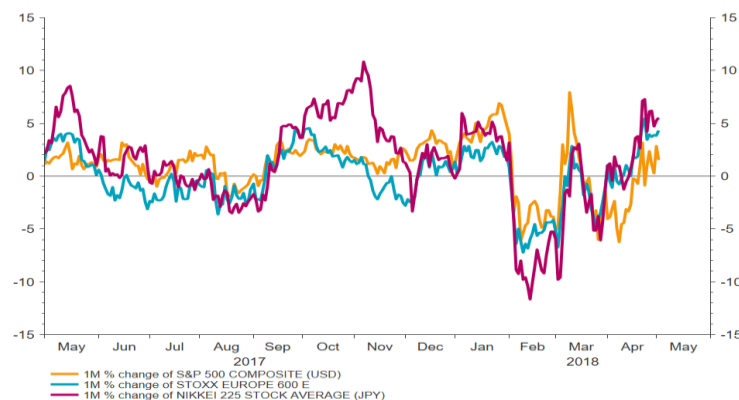
US stocks have lost their mojo



- > The other theme that was of interest in stock markets this month, was the apparent strength reversal that we have seen in US stocks. Since May 2017, US stocks have outperformed European stocks by more than 20% (not taking dividends into account), but since March we have seen a reversal of this trend (see chart on the bottom left). The timing of this reversal seems somewhat strange: growth momentum in Europe has clearly weakened in recent weeks, while the US is on track to report stellar earnings growth – thanks to the corporate tax rate cut from 35% to 21%, earnings are expected to rise by more than 20% in Q1. Additionally, earnings and turnover numbers have been mostly better than expected, which should have given US stocks a bit more of a lift. It is tempting to blame this all on the magic 3% hurdle, but in reality it is probably linked to a number of factors, including the overvaluation of US stocks, weaker momentum for the FANG stocks (on the back of the Facebook debacle) and a logical pullback after the extended rally, as well as the unfavorable currency hedging costs that non-US investors have to pay in order to reduce currency volatility. The cost of one-year carry has risen to 3% for European investors, its highest level in over 20 years. The opposite is true for US investors willing to buy European stocks: they get a 3% bonus by hedging their currency position, while at the same time buying (cheap) European stocks.
- > Over April we increased our exposure to stocks again, as we expect economic and earnings momentum to ultimately resurface as the main drivers for equities.

> Developed Market Equities

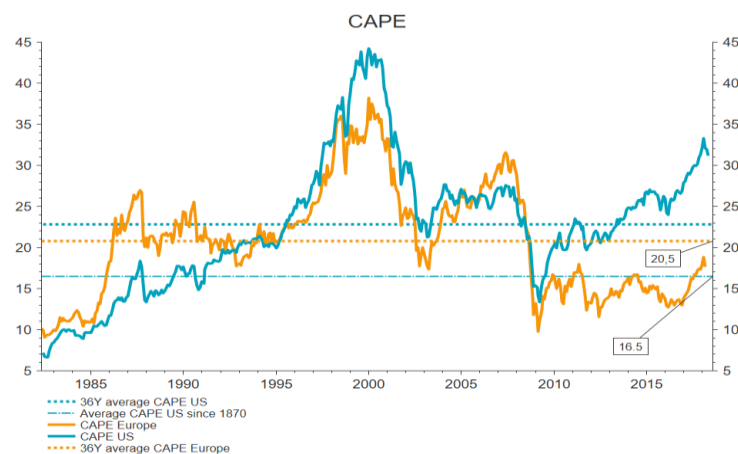
Developed market equities rebounded in April



Source: Thomson Reuters Datastream, Robeco

Source: Thomson Reuters Datastream, Robeco

US and European equities recently became cheaper on CAPE



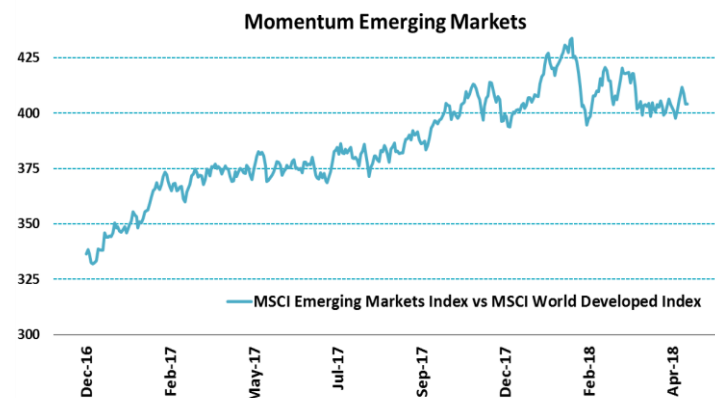
Source: Thomson Reuters Datastream, Robeco

Source: Thomson Reuters Datastream, Robeco

- > In April, developed equity markets seemed to shrug off worries about an imminent trade war, and appeared to be less concerned about protectionist rhetoric. The rising 10-year Treasury yield was at the front of minds, approaching the 3% milestone, while macro momentum weakened. This negative 'discount rate'-related news led the more expensive US equities to underperform versus other developed regions. However, short momentum in developed equity markets overall has turned positive. The ranking on the basis of monthly momentum of equity returns in local currency showed Japanese equities in the lead, rising 4.7% in yen, followed by a 3.7% return for the Eurostoxx 600 in euros. The S&P 500 lagged and ended the month 0.2% higher in dollars. Considering the longer trend in developed equities, long momentum (12M-1M) in local currency is positive for both US and Japanese equity markets (9.7% versus 14.3% respectively). Eurozone equities still show a negative 1.2% return over the past 11 months.
- > Looking ahead, macro-related risks for developed market equities seem broadly balanced. On the one hand, macro indicators indicate decelerating macro activity, but a recession is no immediate threat. Also, US corporate Q1 earnings have come in very strong, sustaining upward earnings revisions. Global earnings revisions have accelerated again. Valuations have improved also for US equities, with the CAPE now at 31.1, down from 31.9 in March. We have adopted a modest overweight in global equities, with a neutral regional weighting within developed equities.

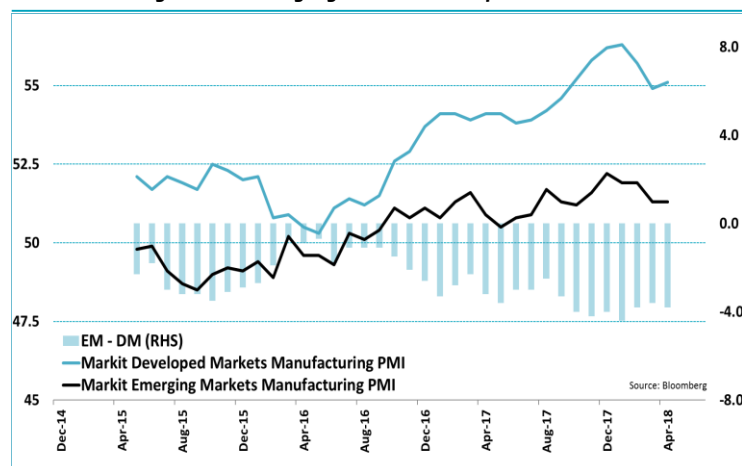
> Equities: Emerging vs Developed (I)

Emerging market equities – momentum



Source: Bloomberg

Manufacturing PMI – emerging versus developed markets



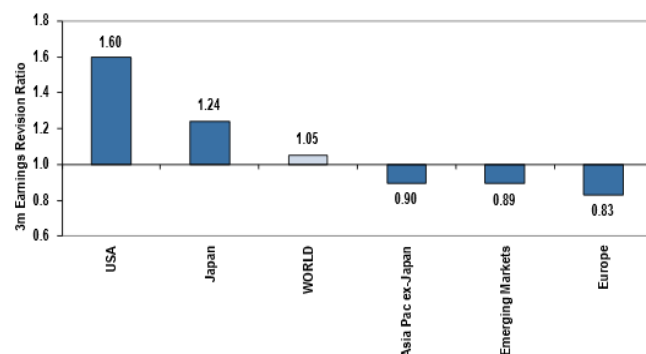
Source: Bloomberg

- > Emerging market equities underperformed global equities in euros for a third consecutive month. During April, the MSCI Emerging Markets Index in euros rose 1.3%, compared with a gain of 1.9% for the MSCI World Index hedged into euros. As the chart on the top right shows, we are at interesting levels for the MSCI Emerging Markets Index, as the uptrend that we have seen throughout last year could be broken.
- > Last month we mentioned the increased probability of a China-US trade war as one of the reasons for us to initiate an underweight position in emerging market equities. Over the course of April, the dialogue seems to have become a little more constructive, though no actual steps have been taken. As Bloomberg put it: "US-China trade talks end with key differences still unresolved." We continue to believe that emerging markets will be among the asset classes hardest hit if trade tensions do escalate.
- > From a macro perspective, things have yet to improve as well. The global economy has been decelerating somewhat since the start of this year, and emerging economies are no exception. China's growth is keeping up, however, but its massive corporate debt pile prevents it from actually increasing. As the chart on the bottom left shows, emerging markets have not really profited from the significant improvement in developed market economic momentum that began in 2016, and it is unlikely they will take over from developed markets any time soon.

> Equities: Emerging vs Developed (II)

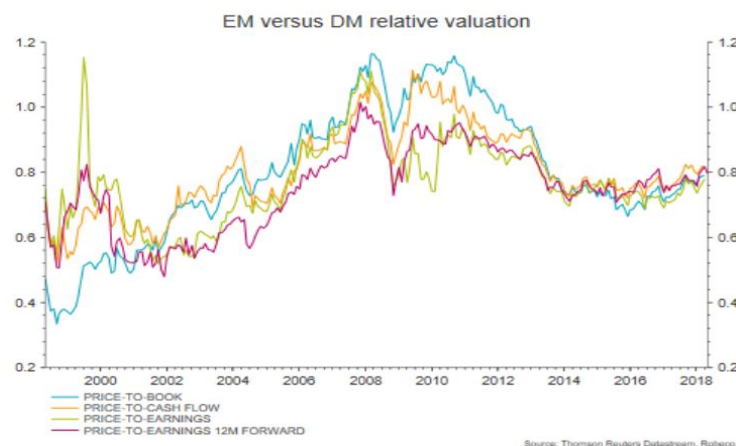
Earnings revisions

Chart 6: Earnings Revision Ratio by Region - Last 3 Months



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

Valuation

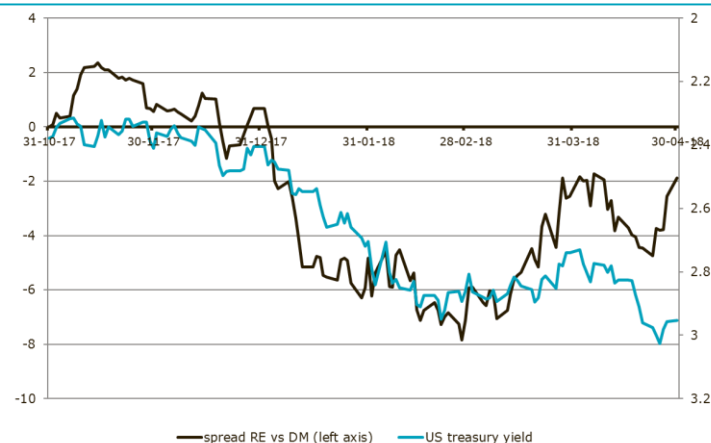


Source: Thomson Reuters Datastream, Robeco

- > In addition, the monetary policy mix doesn't look that constructive either. Liquidity growth will be reduced only slowly, but recent events make it more likely that the US dollar will appreciate further, at least in the short run. With the Fed committed to further hike rates, other central banks like the BoJ and ECB are showing more reluctance to end their QE programs. This could help the dollar to strengthen, which is a negative for emerging markets.
- > Things have also worsened from a bottom-up perspective. The 3-month earnings revisions rate has dropped below 1, as earnings growth has disappointed somewhat, even as growth numbers are pretty decent. We should add here, however, that earnings revisions have come down in other regions as well.
- > Valuation for emerging markets looks reasonable; stocks in the US in particular are more expensive. Valuations have risen slowly but surely since the beginning of last year. Over a longer-term horizon, a 20% discount to developed market equities is still sizeable, but it also implies that emerging equities are no longer outright cheap.
- > An increased probability of a trade war between China and the US, the perspective of a stronger dollar, and earnings growth below expectations makes us more cautious on emerging market equities for now.

> Real estate

Volatile relative return



Source: Bloomberg, Robeco

Discount to NAV of global real estate

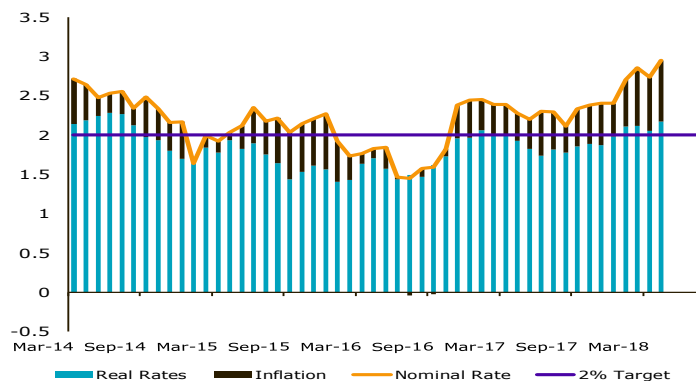


Source: Worldscope, I/B/E/S, DataStream, UBS estimates, as of 30 Apr 2018.

- > In April, the S&P Global Developed Property Index (in US dollars) rose 1.9%, while global equities (also measured in dollars) rose 1.1%. In the year to date, the underperformance of real estate is still around 2%.
- > The outperformance in April came after a bit of a bumpy ride, with real estate initially rather weak. The US Treasury yield hit the 3% level in April, leaving a spur of nervousness in the US markets. After the yield started to drift lower again, real estate managed to rebound, erasing the underperformance. It's getting a bit boring, but it is still the US Treasury yield that determines the development of listed real estate. As we expect an upward trend for the yield, we do not expect listed real estate to outperform this year.
- > However, if we look at other metrics, real estate is becoming more attractive. The global economy is still strong, driving demand for real estate higher. The dividend yield spread is still in favor of real estate, and the sector has proven to be some kind of safe haven in volatile equity markets. In the US and Europe, real estate trades at a discount to the Net Asset Value, while Asian real estate is at par on that metric. Other valuation measures confirm this general picture.
- > Valuations of real estate are relatively attractive, and the economic cycle is also in its favor. However, the correlation with the Treasury yield is still strong. As we expect higher yields, we stick to our neutral position for real estate.

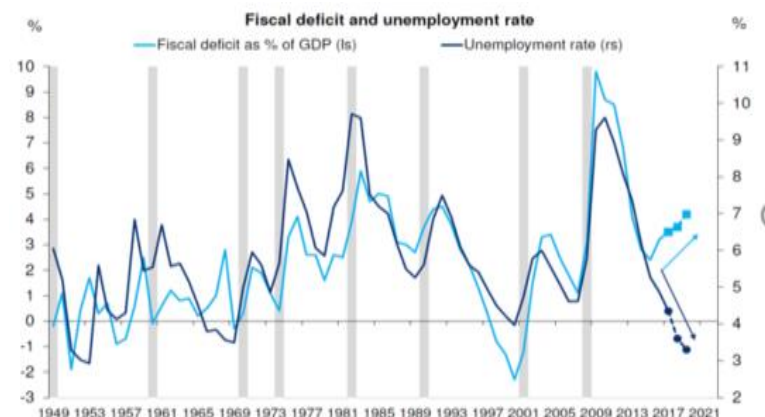
> AAA Bonds (I)

Dissecting the 10-year US yield: real rates have been moving higher



Source: Bloomberg & Robeco

Business cycle: the fiscal deficit versus the unemployment rate

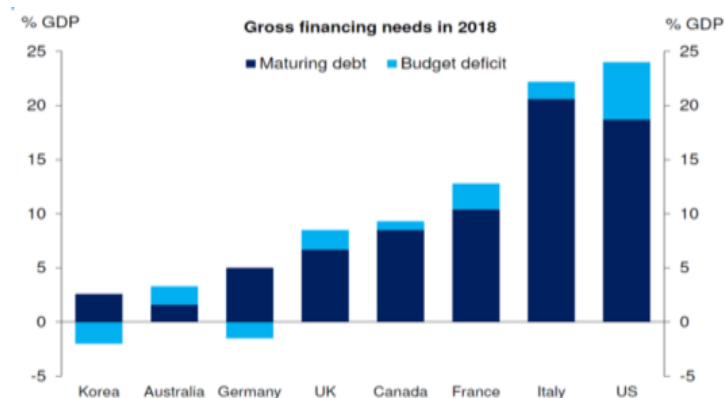


Source: Deutsche bank Research

- > After dropping in March, government bond yields reversed course in April, with the US market acting as the general catalyst to drive global sovereign yields higher. The 3% level acted as the magic number that everyone was watching out for, a yield level last seen almost four years ago. From a technical perspective, the question now is will 3% turn out to be just as formidable a support level as it has been a resistance level over the past years. So far this hasn't been the case, as 10-year US Treasury yields failed to stay above 3%.
- > Since Trump's electoral win, the main driver of nominal rates has been the real yield component. During this time, inflation expectations just meandered around the 2% level. In 2018, however, we are witnessing back-to-back increases in priced-in inflation. It looks like the pro-cyclical policies of the Trump administration are really starting to have an impact. The combination of widening deficits and very low unemployment is one that we haven't seen since the 1960s.
- > We expect the Fed to stick to its plan and continue to raise rates by 25 basis points every quarter in 2018. With the core PCE for March coming in at 1.9%, 5-year/5-year forward inflation over the past four months remaining in a comfortable 2.25% to 2.5% range, and wage growth finally becoming firmer, we can't find a reason for the Fed to change its course. We see the soft first-quarter GDP figure as a temporarily setback due to the weather and the by now the all-too-familiar pattern of weaker first-quarter GDP numbers. If we are indeed right there is >>

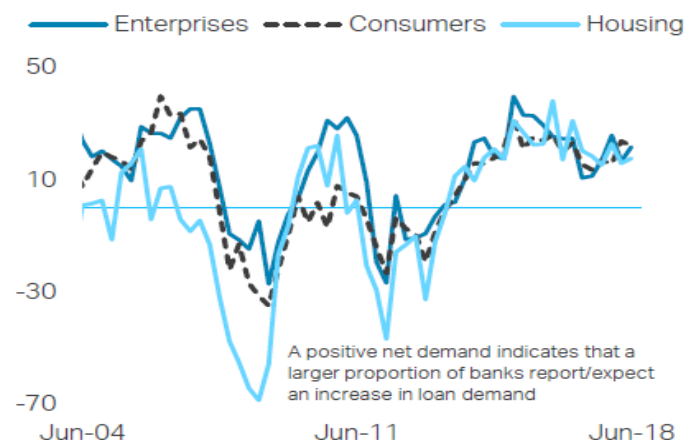
> AAA Bonds (II)

The US faces massive refinancing needs in 2018



Source: Deutsche bank

Loan demand is expected to remain positive in the Eurozone

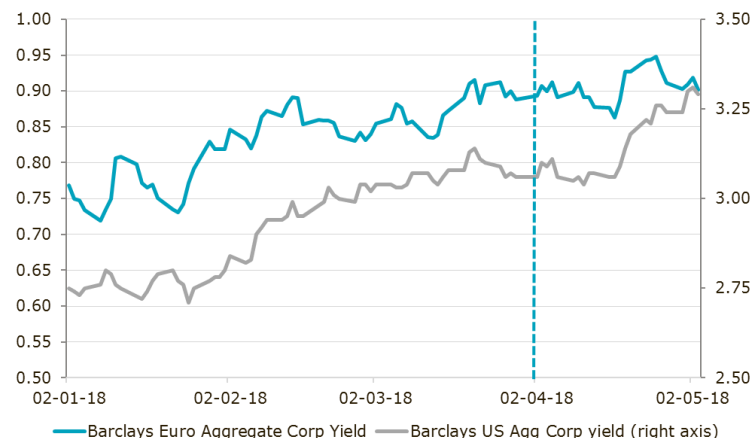


Source: Lombard Street, ECB

- > room for the market to start moving more towards the Fed's rate path. The gap between the market and the Fed's median dot plots for 2018 and 2019 is around 21 basis points and 65 basis points respectively.
- > We will carefully monitor the `appetite for Treasuries in the coming period, as the US has a massive financing need in 2018. We expect this to be mostly financed through shorter-term paper, and expect the impact on the longer part of the curve to be minimal.
- > Data in the Eurozone continues to come in softer than expected. We currently don't think this is a major risk, as we see this as just a healthy correction from an unsustainable growth level to a more sustainable one. We see the latest purchasing managers index number as confirmation of this. After moving lower in February and March, it stabilized comfortably above the 50 threshold in April. A big positive is that credit standards continue to ease, and that credit demand is expected to pick up. This is happening across both households and businesses. The ECB remains in wait-and-see mode, and at its latest meeting gave no indication about the timing of any policy change.
- > We continue to stick to our long-term view that rates will ultimately need to move higher. We think it's highly likely that the soft patch in the data is temporary, and when it reverses it will provide a further boost to yields.

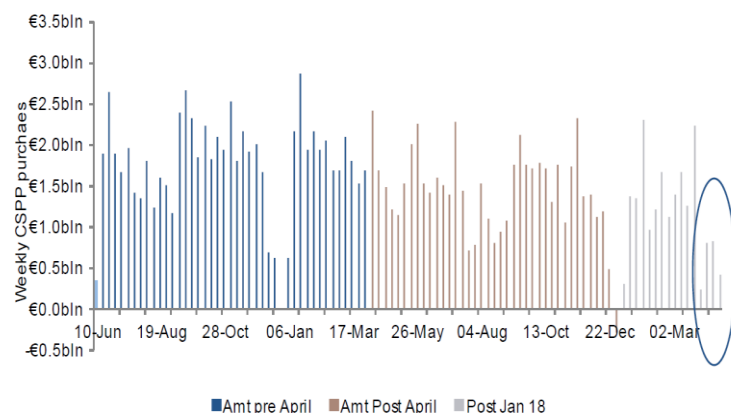
> Investment Grade Credits (I)

Yields in the US and Europe



Source: Bloomberg, Robeco

The trend in CSPP buying is downwards



Source: ECB, SG Cross Asset Research/Credit

- > Little happened in the European credit markets during April. Spreads did move up and down a bit, but at the end of the month, the European credit yield had risen by one whole basis point to 0.90, while the spread declined 3 basis points.
- > In last month's ECB meeting, President Draghi only signaled an 'unchanged confidence' in hitting the 2% inflation objective, but didn't make any remarks about the CSPP program. Officially, the program runs until September, and has been a firm support for credit markets. The absolute amount of the bond buying is on a downward trend though, with low amounts of CSPP buying seen in recent weeks.
- > Yet, spreads and yields weren't influenced very much and remained at low levels. That development was mainly due to some technical aspects, as relatively low issuance kept the markets balanced. It could well be a 'calm before the storm' as some analysts note. Depending on whether the CSPP program ends in September (earlier isn't very likely any more) or later, spreads will widen and we will see more volatility, since markets will no longer have an ultimate buyer. It is likely that we will see more volatility once the CSPP decision is announced. The next step, an ECB rate hike, seems to be something for the far future.
- > European investment grade credits have an overweight position in our portfolios, as we expect a better return compared to negatively yielding cash. However, we see risks for European credits increasing.

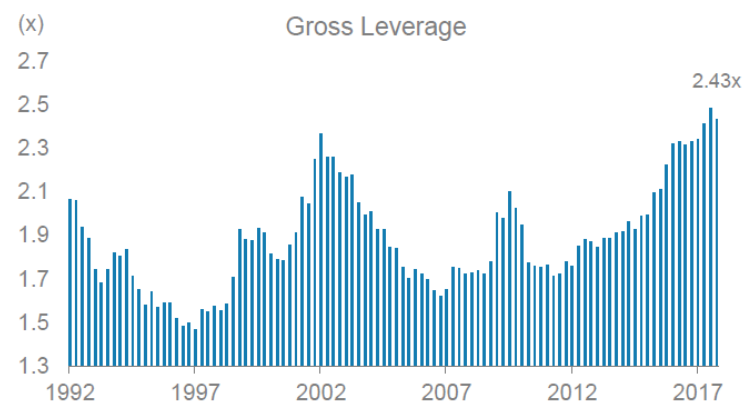
> Investment Grade Credits (II)

Foreign investors withdraw their holdings in US corporates



Source: Morgan Stanley

US leverage is still at high levels – a problem if yields rise



Source: Morgan Stanley, Bloomberg

- > The US credit yield moved along with rising US Treasury yields and gained 25 basis points, while the spread remained flat at around 110 bps. Economic data from the US is still strong and the last Fed meeting didn't surprise the markets.
- > There are plenty of risks for US credits however. On the macro side, there is the potential trade war between the US and China that is still hanging above the market. Added to this are the rising sovereign yields and a stronger US dollar, in combination with increased currency hedging costs, making US credits unattractive to invest in. Foreign investors are already withdrawing funds from the US. Besides the macro environment, other fundamentals for credits aren't favorable either. Leverage has come down a bit, but with rising yields, the interest coverage – the ability to pay interest payments – could become a more pressing problem moving forward.
- > The overweight position that we currently have in credits is taken from a technical position rather than from a convincing credits outlook. Yields in the US seem attractive, but they carry a lot of risks. European credits still have the ECB as a back-up, but the clock is ticking. The main reason why we are still interested in this asset class is that it is less bad than negatively yielding cash. We will watch the next steps of the ECB with a lot of caution.

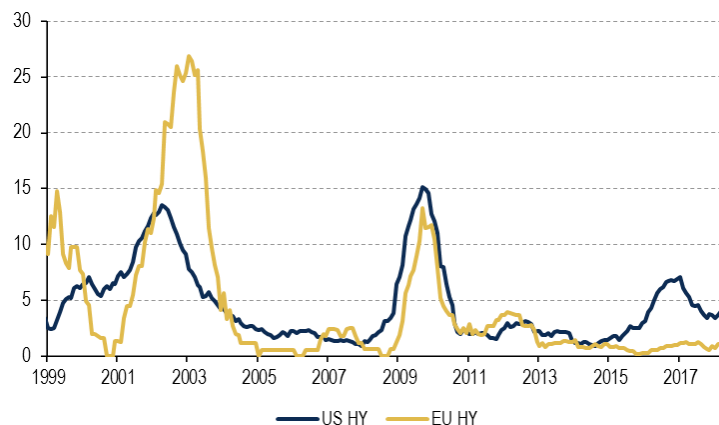
> High Yield (I)

High yield – spread



Source: Bloomberg

High yield – defaults

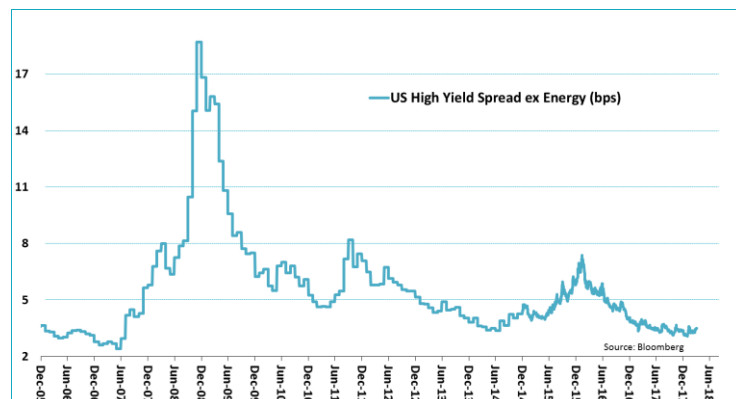


Source: BofA Merrill Lynch

- > Global high yield bonds fell 0.1% in April, recording their third consecutive month with a negative return. However, global investment grade credits and local currency emerging debt realized a bigger loss (0.7% and 0.8% respectively), making high yield bonds the best-performing fixed income asset class. The average spread fell marginally from 357 basis points at the end of March to 350 at the end of April.
- > Despite the relative positive performance compared to other bond segments (absolute return year-to-date is -2%), we still see little value in high yield bonds. Both spreads and yields remain near historically low levels. Return buffers against less favorable circumstances are extremely thin. In addition, the duration of high yield bonds has risen modestly but steadily over the last 12 months, making them more vulnerable to rising yields.
- > It is precisely the possible rise in government bond yields that could hurt high yield in the near term. While major central banks outside the US seem hesitant to end their massive quantitative easing programs, the Fed seems determined to continue its rate-hiking cycle. We also do not rule out the possibility that markets could get a little more wary about a potential overheating of the US economy at a time when they are still pricing in fewer rate hikes than the Fed dot plot indicates. Since US high yield companies represent, by far, the biggest weight in the global high yield bonds benchmark, rising US Treasury yields would be a negative for the asset class.

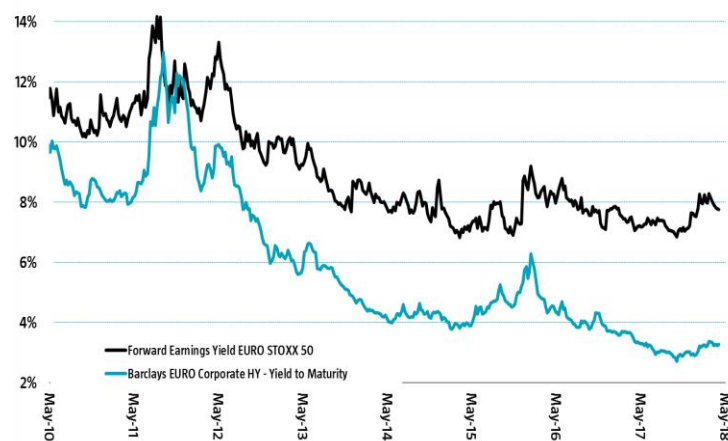
> High Yield (II)

High yield – energy spread



Source: Bloomberg

High yield – relative valuation against equities

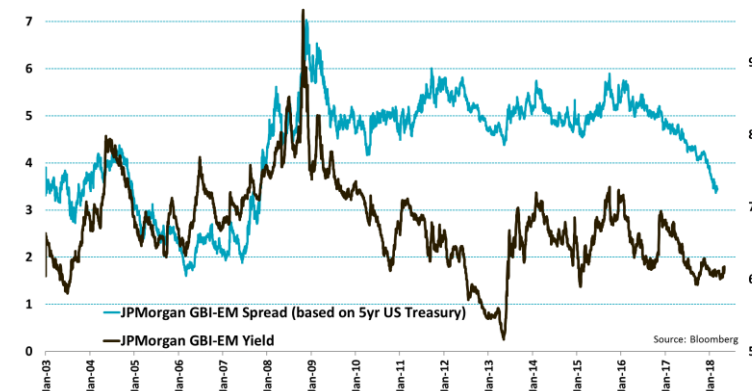


Source: Bloomberg

- > On a more positive note, we do not expect a massive widening of high yield bonds spreads in the (very) near future. Global economic growth is solid and is expected to remain so. This helps earnings to continue to grow. Also, while we expect yields to rise, they are still at low levels. Taking into account the profile of maturing debt, which looks pretty benign, a widespread default wave should be unlikely. Higher oil prices also make it less likely that defaults will spike. Since the rise of US shale producers, many of them being US high yield companies, the weight of the energy sector has steadily increased. Oil prices near or at USD 70 per barrel are sufficient for shale gas companies to make decent profits.
- > We would like to repeat our notion from last month, that defaults for smaller companies have been rising for some time. Historically, small caps start to default before larger companies do. This is something to keep an eye on.
- > High yield bonds look expensive compared with most other asset classes. The chart on the bottom left shows the relative valuation of high yield against equities. This is especially the case in the Eurozone, but applies to US high yield bonds as well. At current valuations, we think only Eurozone government bonds look less appealing within the fixed income space.
- > We hold on to our underweight in high yield bonds, based on negative momentum and elevated levels of valuation. Equities offer a more attractive risk-return profile.

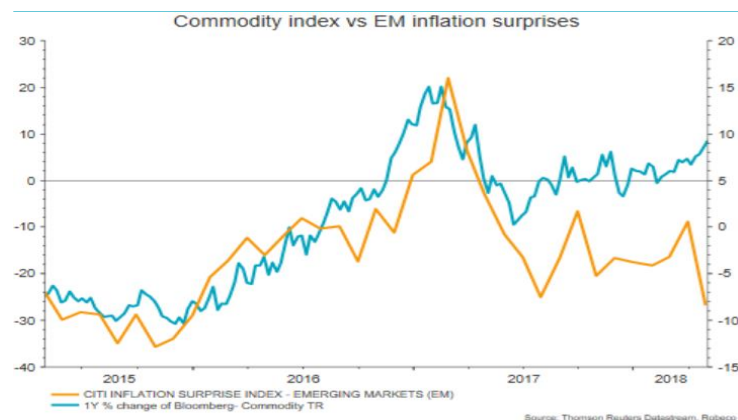
> Emerging Market Debt (I)

Emerging market debt in local currency – spread and yield



Source: Bloomberg

Emerging countries show negative inflation surprises despite rise in oil price

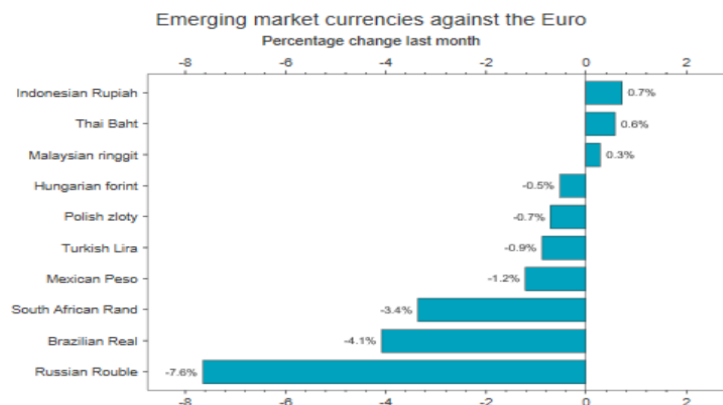


Source: Thomson Reuters

- > Local currency emerging market debt (EMD) unhedged in euros turned negative in April, losing 0.8%, even as uncertainties about an imminent trade war faded somewhat, while oil prices increased 8.7%.
- > With yields for local currency emerging market debt still just above 6%, the yield compares favorably with other fixed income categories such as high yield, especially when correcting for underlying credit quality. Yields declined somewhat last month as the asset class remains well bid, and attractive alternatives within the traditional fixed income spectrum are scarce. From a yield perspective, the asset class does not seem expensive compared to its own history, in contrast with alternatives such as high yield corporate bonds.
- > However, for expected total returns, underlying local currency movements are even more important for EMD. Here, we note that the top 10 issuers are becoming less attractive. Judging from our simple FX valuation model based on purchasing power parity, the average valuation of these top 10 issuers currently shows a discount of just 2%. The near-10% discount observed in early 2013 (around the infamous taper tantrum) has largely disappeared by now. Although emerging currencies can show large and persistent episodes of FX valuation overshoot, the valuation signal has now moved from positive to neutral in our view. The monetary policy outlook for EMD still leans to the dovish side compared to US policies, with emerging market inflation at subdued levels, which does not provide a trigger for strong currency appreciation either.

> Emerging Market Debt (II)

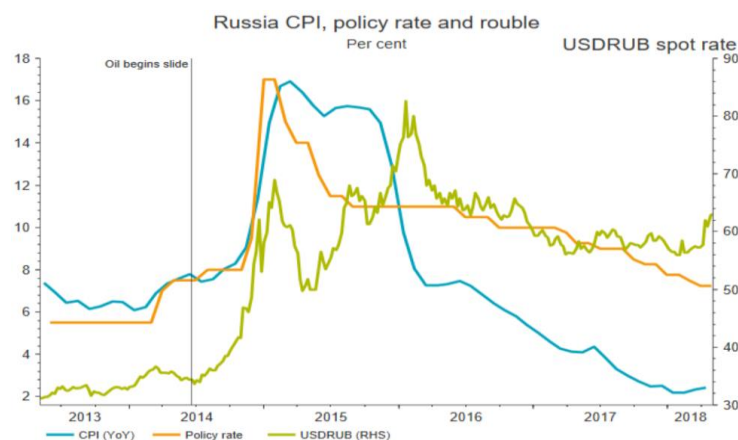
Emerging currencies



Source: Thomson Reuters

Source: Thomson Reuters Datastream, Robeco

Russian ruble declines as central bank allows currency to slip

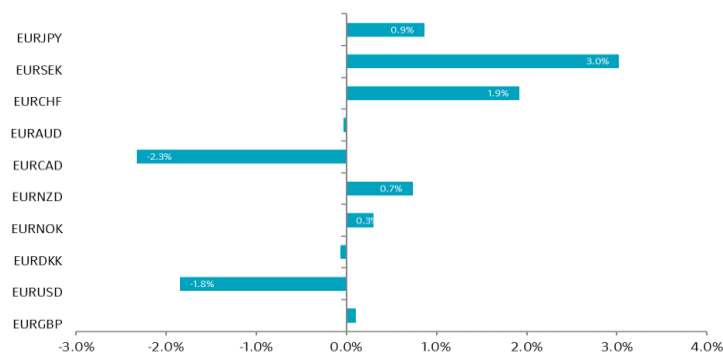


Source: Thomson Reuters

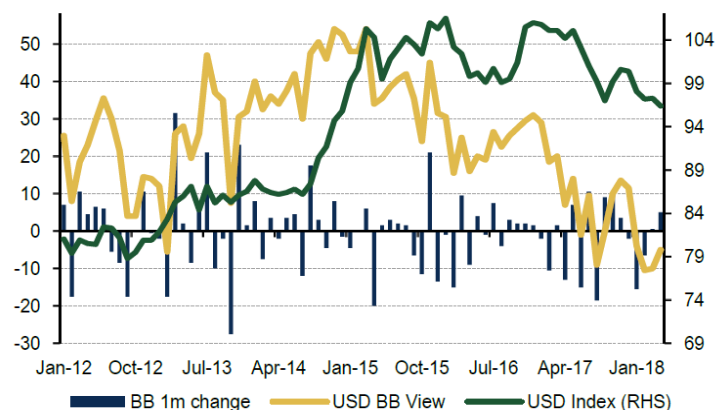
Source: Thomson Reuters Datastream

- > Currency performance within EMD issuers remains diverse. Asian countries typically profit from the growth pick-up in China, which reported a 6.8% (year-on-year) rise in activity, above China's target of 6.5%. Elsewhere, macro developments are less benign for emerging market investors. In Mexico, despite a benign economic backdrop and positive signs around NAFTA, the peso dropped last month against both the US dollar and the euro. The reason for this is the rise in the polls of leftist nationalist leader Lopez Obrador ahead of the July elections. As the S&P downgrade has already indicated, developments in Turkey have worsened for investors. Inflation rose to 10.9% in April, illustrating that past rate hikes by the Turkish central bank have not had enough effect in taming inflation. The central bank hiked the policy rate by another 75 basis points in late April. Finally, the hardest-hit currency within the top 10 local EMD issuers universe was the Russian ruble, as new US sanctions were imposed on Russian companies such as Rusal.
- > A notable development for emerging currencies was renewed US dollar strength, which increasingly led to pressure near the end of the month. Emerging market resilience to external shocks has improved over the recent years as FX buffers were built up, but susceptibility to a reversal of the well-known carry trade remains. We expect that the recent US dollar rally has further room to run, since other central banks have few incentives to increase policy rate hike expectations versus the Fed. Overall, we further reduced our overweight in EMD in local currency to neutral this month, as we think the current positive carry is barely sufficient to shield from the expected negative currency impact.

> FX (I)

G-10 currencies: the Canadian dollar is the winner

Source: Bloomberg, Robeco

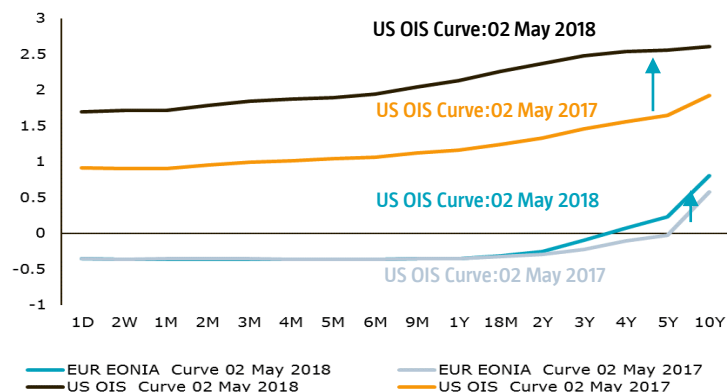
Few US bulls and many bears are paying a hefty carry

Source: BofA Merrill Lynch Global Research

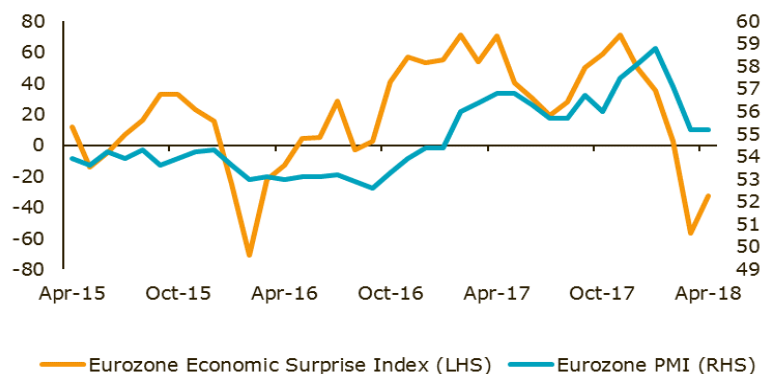
- > The currency to end up on top of the league tables in April was the Canadian dollar, while the weakest link was the Swedish krona, which suffered due to another weak inflation print and a central bank that pushed a change in monetary policy into the future. The Canadian dollar continues to benefit from the strength of the oil price. The market shrugged off dovish comments from the Canadian central bank and still expects two more rate hikes for the remainder of the year. This is a very high bar and in our view minimizes the ability of the Bank of Canada to deliver an upside surprise.
- > At first glance, no coherent theme can be derived from G-10 currency returns in April. This changes when you start cross-checking one-month changes in short-term interest rates with one-month changes in currencies. It becomes apparent that most rates and currencies are recoupling, with the exception of the New Zealand dollar, the Australian dollar and the Swiss franc.
- > While the US dollar was neither the strongest nor the weakest currency, the focus was definitely upon it, after it suddenly reversed course following months of constant weakening. The trigger for this was apparently the break higher in long-term bond yields.
- > So, why now the sudden recoupling of rates and the US dollar? We think we are witnessing the capitulation of short dollar positions due to the cost of carrying these positions. A hefty carry cost (for the past >>

> FX (II)

Divergence remains between the US dollar and euro over the past year



Data releases are starting to stabilize in the Eurozone



- > two months) and the absence of an obvious trigger to break higher makes it an unrewarding position. Additionally, US data has been much better than that of the rest of the world, with growth plateauing in the Eurozone. This raised the concern that monetary divergence is still alive and might even have further to go.
- > Last year, the market at one point got very excited by the thought that the end of the bond purchasing program was not too far away, and that monetary convergence would be the new theme. The ECB has masterly managed to curb this enthusiasm. Forward guidance, the continued delaying of announcing the end of the purchasing program, and insisting that rates can only be raised after the purchasing program, has dampened markets expectations. The recent weakness in macro data has also undoubtedly helped boost the ECB's credibility.
- > The yen was one of the first currencies that reacted to the increase in yields. The market is playing with the idea that the BoJ is going to adjust its yield curve control policy, and that this will be the first sign of tightening. We disagree, as we think that the BoJ remains committed to reaching the 2% inflation target, so we don't expect a change in policy.
- > We closed out our underweight US dollar position. We did this through closing out our short dollar position against both the yen and euro.

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