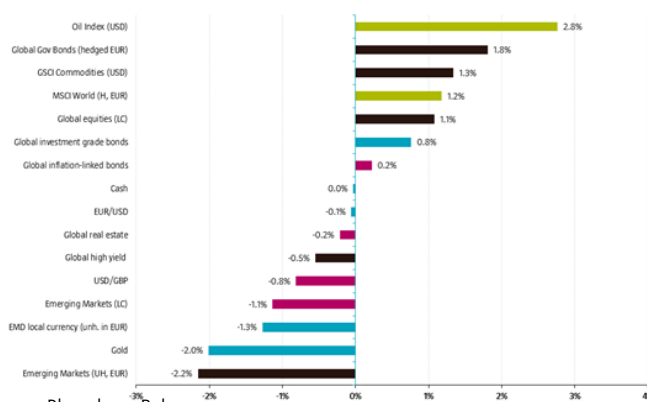


## Multi-asset market outlook

For professional investors  
September 2018

## General overview

### Developed markets up, emerging markets down



Source: Bloomberg, Robeco

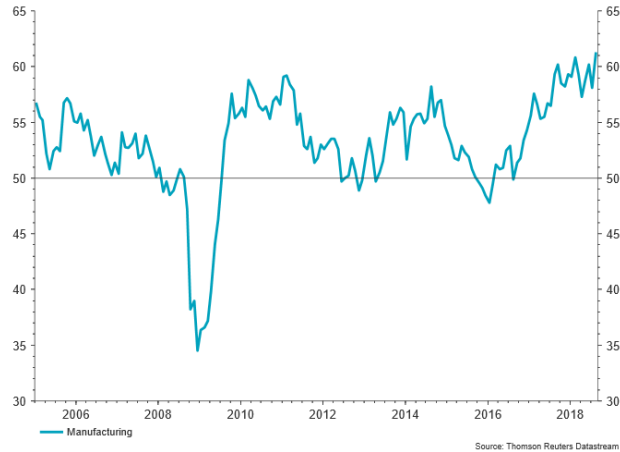
### Number of tactical positions is limited at the moment

	Portfolio	BM	active
Equities Developed Markets	28.00%	25.0%	3.0%
Equities Emerging Markets	4.0%	5.0%	-1.0%
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+	7.50%	7.5%	
Investment Grade Corp Bonds	20.0%	20.0%	0.0%
High Yield Corp Bonds	1.0%	5.0%	-4.0%
Emerging Market Bonds LC	5.0%	5.0%	
Cash	4.500%	2.5%	2.0%
EUR/USD	0.0%	0.0%	
EUR/JPY	0.0%	0.0%	
EUR/GBP	0.0%	0.0%	
EUR CASH	0.0%	0.0%	

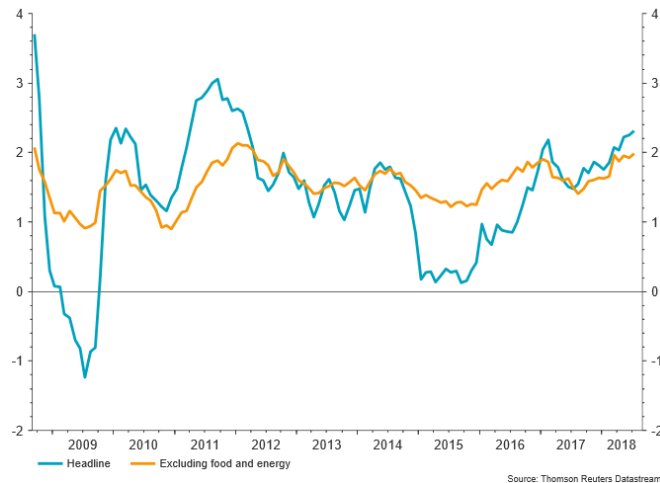
- > In August, the desynchronization between equity markets continued. While US equity markets hit new all-time highs, conditions for several emerging markets deteriorated further. As has been the case many times over the past years, political uncertainty increased in Europe.
- > Turkey remained at the center of emerging instability. Its national bank refrained from rising interest rates and triggered a massive sell-off of the Turkish lira. This led to a further deterioration in confidence in emerging markets as a whole. The process of digesting the impact of the trade conflict and the US Federal Reserve’s tightening program remains painful for emerging markets.
- > Developed markets fared well last month, but when we take a closer look, there is a notable divergence between the US and Europe. The records achieved in US markets confirm that corporate earnings matter, even if your president is Donald Trump. That said, earnings in Europe aren’t bad either. Unfortunately, political risks in Europe are currently higher than in the US. Given the European need to deal with both Brexit and the anti-establishment government in Italy, it shouldn’t be a surprise that investors are a bit nervous.
- > Our preferences didn’t change much over the summer – we remained overweight equities and still prefer developed equities over emerging markets. We are underweight high yield bonds, though we are starting to see some light at the end of the tunnel for this asset class.

> United States

Very strong US August ISM manufacturing figures



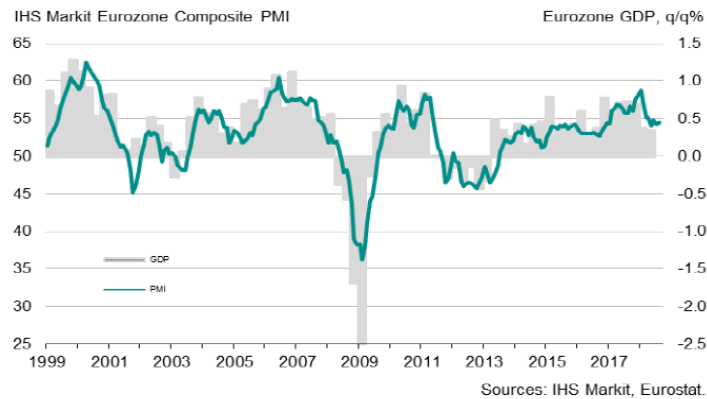
PCE is paving the way for a modest September rate hike



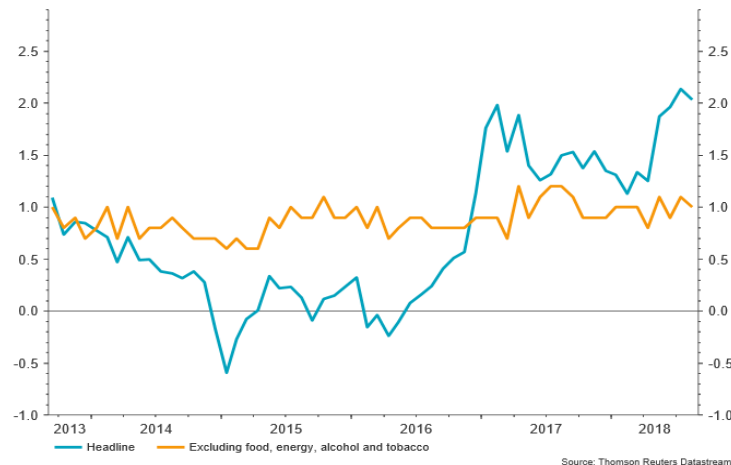
- > The US economy continues to do well. The ISM manufacturing index jumped to 61.3 in August from 58.1 in July, the highest level since May 2004. The sub-index for export orders, however, fell in August, not surprisingly as a consequence of the strength of the dollar (the trade-weighted dollar has risen by more than 5% this year so far).
- > The US president, once again breaking precedent, has publicly criticized the monetary policy of the US central bank (the Fed), saying he was not “thrilled” by the current policy of monetary tightening. As the inflation indicators preferred by the Fed, the personal consumption expenditure indices, are now on or above the target of 2.0%, there is little to stop the Fed from raising short-term interest rates by a modest 25 basis points on September 25, if only to demonstrate its independence. Given the favorable economic environment, it is also likely to keep its forward guidance unchanged, suggesting continuing monetary tightening at a modest pace.
- > The US/Chinese trade war shows no signs of abating. By the end of September both countries will likely have imposed tariffs on goods and commodities to a value of USD 360 bln, which is equivalent to around two-thirds of their bilateral trade last year. The level of tariffs is still modest, so a further escalation is possible. Political support for protectionist measures aimed at China is wide ranging, so a change in the composition of the US Congress after the mid-term elections will make little difference in terms of trade policy.

## > Europe

### Eurozone economy moved sideways in August



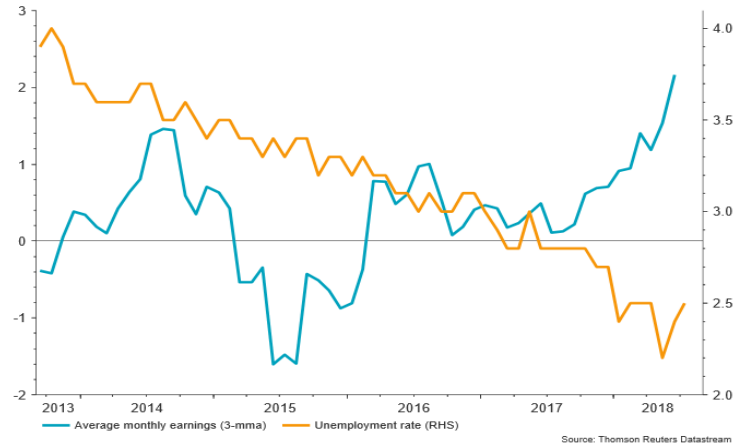
### Core Eurozone inflation remains tame



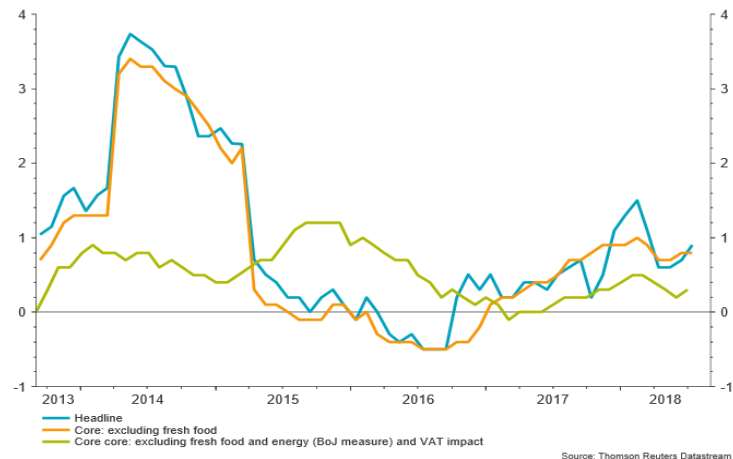
- > The Markit Eurozone Composite reading in August was 54.5, marginally higher than July's 54.3. Growth in France and Germany (as also signaled by the strong rise in the IFO Index) was particularly strong. This was compensated by Italy, where economic output has risen at the slowest rate in 22 months.
- > US trade policy remains a downside risk for European growth, given the unpredictability of an increasingly beleaguered US president. At a recent campaign rally in West Virginia, Trump said: "We're going to put a 25% tax on every car that comes into the United States from the European Union."
- > The budget for 2019 of the new Italian government, to be discussed at the end of this month, is eagerly awaited by financial markets. There are some signs that EU rules will continue to be respected, despite expensive election promises. The government is allegedly working on a three-year timeframe. Deputy Prime Minister Matteo Salvini, leader of the populist Northern League as well as interior minister, has promised to respect "all" EU restrictions. It is unclear whether his coalition partner, the anti-euro Five Star movement, agrees, so surprises on this matter in the coming weeks can't be ruled out.
- > Headline inflation in the Eurozone in the meantime has surpassed the target of the European Central Bank (ECB) of an inflation rate below, but close to 2.0%, due to the rise in energy prices (9.2% on a yearly basis in August). However, core inflation continues to remain subdued. The ECB can therefore comfortably stick to its plans to end QE by the end of this year and keep interest rates unchanged until at least the summer of next year.

## > Japan

### Japanese average hourly earnings are on the rise



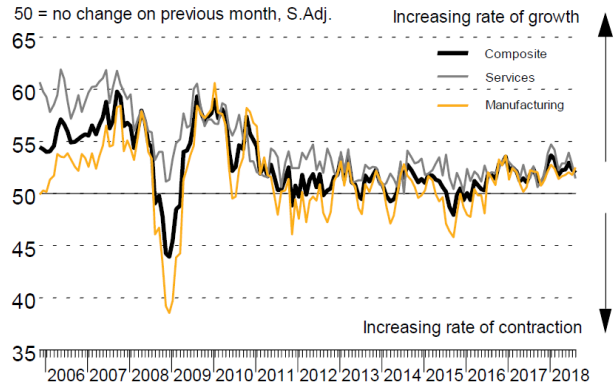
### Japan's 'core' inflation shows modest uptick in July



- > The Japanese economy continues to expand at a modest pace. The composite Markit/Nikkei PMI, which includes both manufacturing and services, rose to 52.0 in August from 51.8 the previous month. Rising protectionism is a threat to Japan's export-oriented economy, but so far this is not reflected in the data, as factor activity strengthened in August. The unemployment rate bounced back from a low of 2.2% in June to 2.5% in July. Still, the labor market remains very tight, as suggested by a further rise in the job offers-to-applicants ratio to 1.63.
- > On September 20, the ruling LDP will hold its customary three-year leadership election, which most likely will be won by the current Prime Minister Shinzo Abe, whose popularity has recovered after a string of scandals. This will pave the way for his continued leadership beyond the Tokyo Olympic Games of 2020. Abe has signaled the wish to raise the retirement age beyond 65, and to allow up to half a million foreign guest workers in five sectors with acute labor shortages: agriculture, social care, construction, hotels and shipbuilding. Abe also vowed to stick to the plan to increase the consumption tax from 8% to 10% in October next year.
- > Japanese inflation remained tame in July. Core inflation (with food prices excluded) was unchanged at 0.8% on a yearly basis. The inflation indicator preferred by the Bank of Japan (the so-called 'core', which strips out energy prices as well) showed a modest uptick to 0.3%, staying far below the BoJ target of 2.0%.

> China

August's Caixin China Composite PMI slips to 52.0



Sources: IHS Markit, Caixin.

Chinese yuan is stabilizing around 6.80

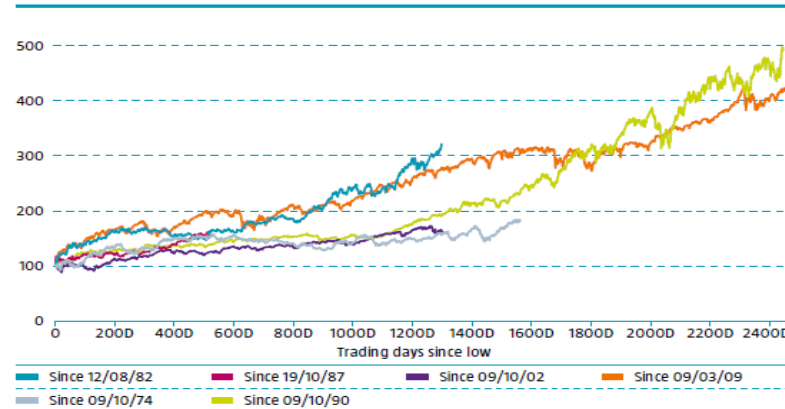


- > The Caixin China Composite PMI, which covers both the manufacturing and the services sector, declined in August from 52.3 to 52.0, signaling a weakening of momentum in the Chinese economy. It is tempting to ascribe this slowdown to the rising trade tensions between China and the US. However, the earlier increased efforts of the Chinese authorities to curb the ultimately unsustainable rise in the debt/GDP ratio by reigning in investments and credit growth was probably a more important factor.
- > The Chinese authorities haven't reacted to the first round of tariffs by intervening in the exchange rate, and that caused a weakening of the renminbi vis-à-vis the US dollar. This signals that they have chosen a milder approach to the renminbi weakening, in contrast to the aggressive stimulus seen in 2008-09. That said, overly drastic weakening is unpopular, and could easily provoke massive capital flight. It is likely, however, that a step-up of US tariffs will lead to a further depreciation of the Chinese currency.
- > Chinese policymakers are now once again increasing efforts to keep Chinese growth at an acceptable level. The central bank, the People's Bank of China, has injected liquidity into the banking system. The authorities have also recently instructed banks (mostly state-owned) to boost lending to infrastructure projects and exporters "facing temporary difficulties". Lending by local governments has been allowed to increase, and taxes have been lowered. All in all, it seems the Chinese government won't tolerate growth that is lower than approximately 6.5%. If current efforts are insufficient, more stimulus is to be expected in the coming months.



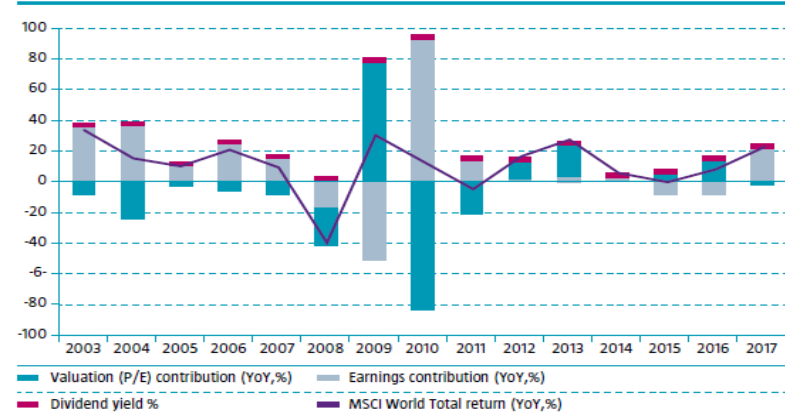
> Equities

**S&P 500 bull markets: post-GFC bull market sets a new record**



Source: Thomson Reuters Datastream, Robeco

**Earnings growth has overtaken multiple expansion as equity return driver**

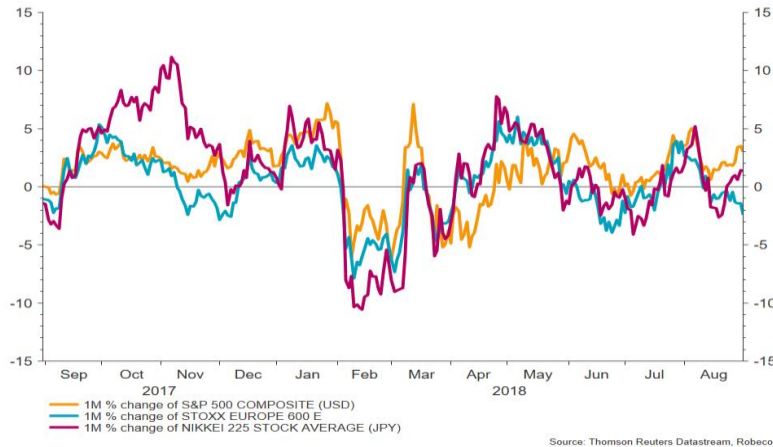


Source: Thomson Reuters Datastream, Robeco

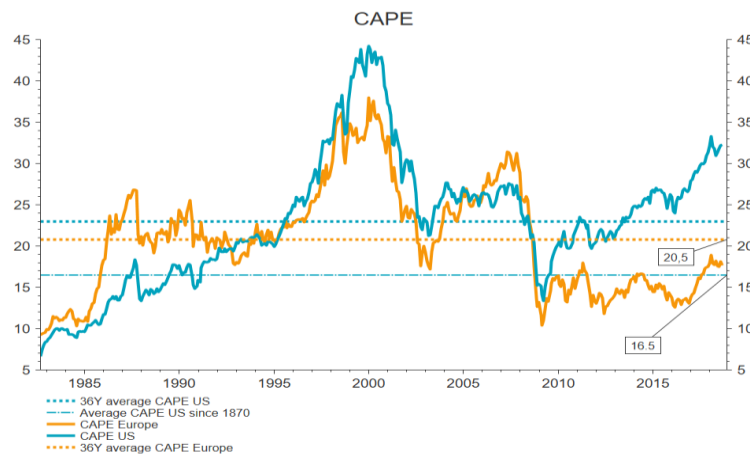
- > The bull market may be ageing, but it set a new record this summer. It started in March 2009 and in August 2018 surpassed the length of the Great Expansion bull market, which lasted from October 1990 to March 2000. Some call it “the most hated” bull market as they perceive it to be artificial due to stimulus roles played by global central banks.
- > Today, this bull market is no longer driven by QE-led asset price inflation, but by real corporate earnings growth. This was evidenced by sound double-digit earnings growth in developed markets over the second quarter. It proves that bull markets don’t just die of old age as long as there is a catalyst that rejuvenates them, in this case the global cyclical upswing which started in late 2016.
- > Still, equity investors have enough to worry about today: high valuations, with the US CAPE at 32.2; rising interest rates; flattening yield curves, and increased protectionism. The (bearish) themes may come and go, but earnings growth and the business cycle drivers remain pivotal in the end. Leading indicators do not yet point to a near-term downturn in the business cycle, and earnings guidance and earnings revisions remain strong.
- > It all looks as if the best way forward is to patiently continue climbing the wall of worry that characterizes this bull market. Therefore, we continue our tactical overweight in equities, and we even extended it a little during the summer, with a preference for developed equities.

> **Developed Market Equities**

**US equity market remains ahead of the pack**



**US stock valuation up, European stock valuations down**



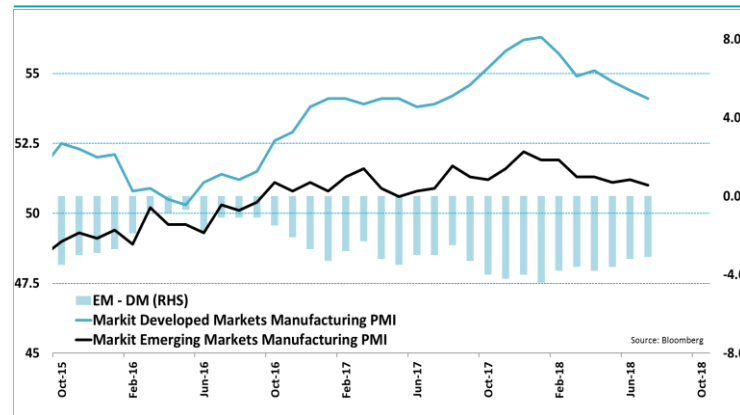
Source: Thomson Reuters Datastream, Robeco

- > In August, momentum stocks outperformed other factor styles, as equities enjoyed a rebound in sentiment. Strong reported earnings growth for developed markets over the second quarter turned out to be more important for equity investors than the still unresolved US/China trade dispute.
- > The monthly momentum of equity returns in local currency showed that US equities kept their positive momentum, generating a dollar return of 3.0% in August. Japanese equities followed at a distance, with the Nikkei in measured yen returning 1.4%. European equities saw outflows and experienced negative momentum, losing 2.4% in August in euros. Long momentum (12M-1M) in local currency remains strongly in favor of US equities (14.7%) and Japanese equities (12.0%). Long momentum for Eurozone equities has now become negative, with a local return of -2.0%.
- > Equity valuations in the US based on the Shiller CAPE showed that US equity valuations are trending up again after a short deceleration in early 2018, with the CAPE now at 32.2. In contrast, European equities saw a de-rating, with the CAPE down from 18.1 to 17.7. European equities remain unloved, despite healthy earnings growth. European equities seem undervalued as economic momentum has improved, but the region's political risks are more important at this moment.
- > The momentum in US equities is the decisive factor for the US preference within the developed market bucket.



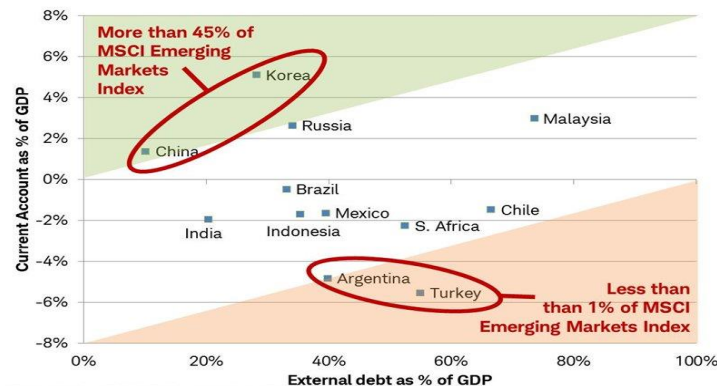
> Equities: Emerging vs Developed (I)

Manufacturing PMI – emerging versus developed markets



Source: Bloomberg

Weight and characteristics for emerging countries



Source: Charles Schwab, International Monetary Fund and World Bank data as of July 2018. The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets countries. With 1,137 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

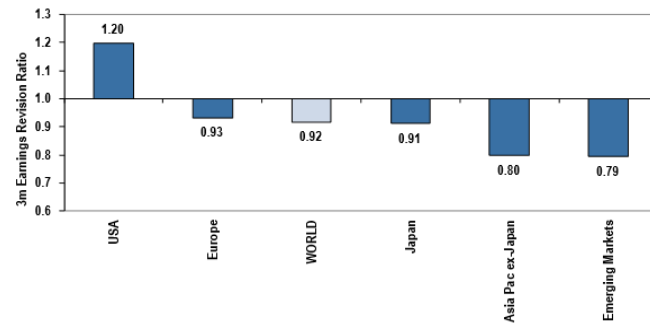
Source: Charles Schwab

- > Emerging markets took another beating in August, as the trade dispute between China and the US intensified, and Turkey's currency crisis soured investor sentiment. The MSCI Emerging Market Index in euros fell 2.2% against a rise of the MSCI World Index hedged into euros of 1.2%. We benefitted from the underperformance as we are underweight emerging market equities.
- > Turkey made headlines in August as the country got caught up in a currency crisis, triggered by a waning belief that its government will deliver a stable economy going forward. Together with Argentina, which had to ask for the help of the IMF, Turkey dented the already shaky investor sentiment towards emerging markets.
- > The direct impact of Turkey (and Argentina) should not be exaggerated, however. Turkey represents less than 1% of global GDP, and less than 0.6% of the MSCI Emerging Markets index. Also, linkages with other economies are relatively limited, suggesting that Turkey by itself is unlikely to cause a broader emerging market crisis.
- > That said, we should not rule this out completely, especially since sentiment is pretty weak to begin with. For some part this has to do with China, as its government is trying to find ways to alleviate the impact of the trade war with the US. China's stimulus options are more limited than they were in the past, since corporate debt levels are high. Stimulating growth through credit growth is unwanted at this point, as the amount of non-performing loans is already rising steadily.

## > 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



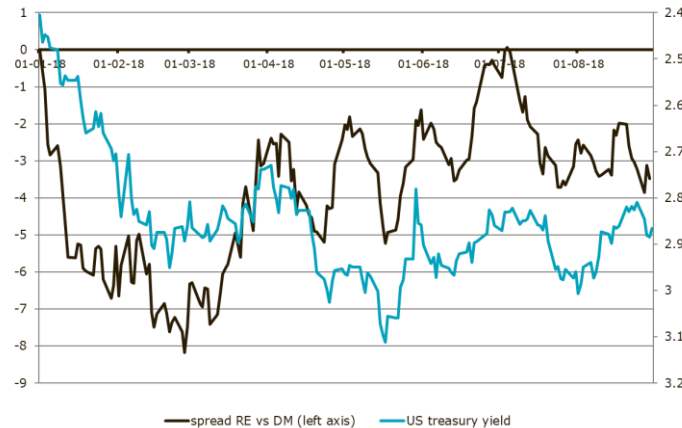
Source: Thomson Reuters Datastream

Source: Thomson Reuters Datastream, Robeco

- > China is subsequently searching for other, more selective measures to prop up growth. In addition, the Chinese renminbi has been weakening, even though the government has made it clear it won't use the currency to fight a potential trade war.
- > Other factors, like we have mentioned before, remain a negative for emerging markets. Earnings growth is solid, but it lags that of other regions. Emerging markets continue to come in last ranked on earnings revisions, as profits growth is being revised down. The US dollar remains strong for now, as the Fed slowly reduces liquidity through higher interest rates and a smaller balance sheet. Historically, Fed tightening has coincided with struggling emerging markets. Finally, relative growth momentum, based on for example manufacturing PMIs (shown on the previous slide), remains tepid.
- > We remain underweight emerging markets. We expect trade tensions to continue, and perhaps increase. This is especially bad news for emerging markets, which on average are more dependent on global trade. Turkey is likely to head into recession, but its weight in the global economy is small. China could still opt for a more broad-based stimulus plan, which would be a positive for emerging equities. Also, the growth momentum could shift a little bit towards emerging countries in the remainder of the year. However, with a strong US dollar and negative momentum, we believe it is too early to become more constructive on the asset class.

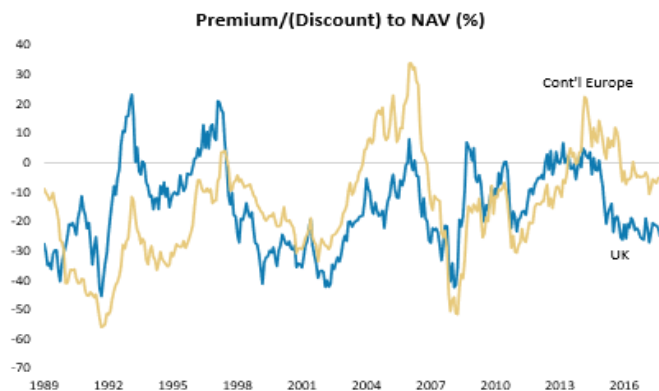
> Real estate

Real estate underperforms global equities... again



Source: Bloomberg, Robeco

European real estate trades at a discount

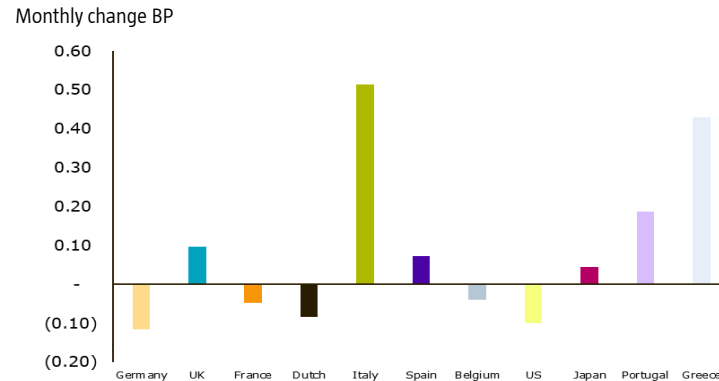


Source: Company data, Datastream, Morgan Stanley Research

- > In early July, the S&P Global Developed Property Index (in US dollars) had erased the year-to-date underperformance against global equities, but it only took a couple of weeks before real estate was back at underperformance levels, heading to -3.0%. Real estate yielded 1.6% in the last two months, but global equity did much better, returning 4.4%.
- > The tight correlation between the US Treasury yield and the relative performance of real estate against global equities has loosened. The US Treasury yield has remained within a narrow bandwidth of between 2.8% and 3.0% for a while now, while real estate returns have been more volatile in recent months. It may be a sign that the strong correlation of the last few years is fading, but it is too early to say.
- > The earnings season showed good results on average in the real estate sector, with a majority of companies beating estimates. The economic environment is a positive factor for the sector, as economic indicators show no signs of deterioration. The uncertainty caused by the trade conflict between the US and the rest of the world so far seems to have had little effect on the US economy. European real estate has an attractive valuation as it trades at a discount on several metrics. However, European real estate also underperformed equities.
- > Although the overall picture for real estate looks relatively good, we prefer to remain neutral within an overweight position in equities.

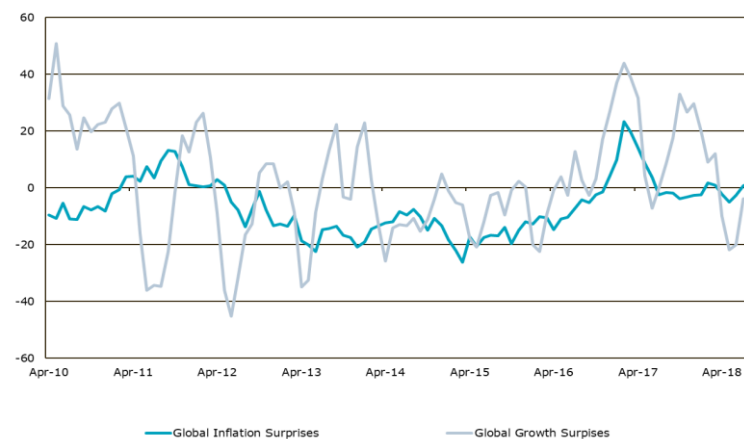
> AAA Bonds (I)

10-year rates in August: a mixed bag



Source: Bloomberg & Robeco

The macroeconomic pulse has been slowing over recent months

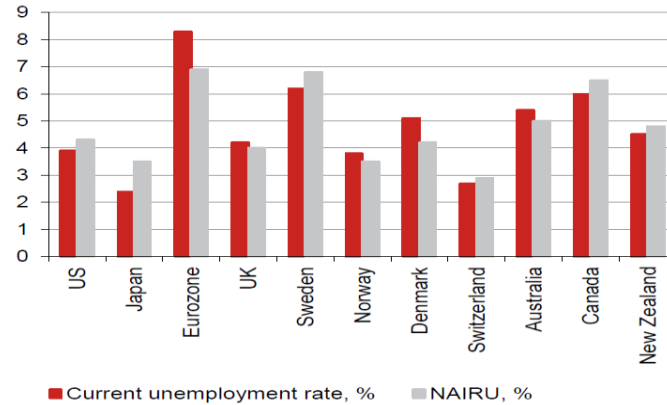


Source: Bloomberg & Robeco

- > In August, changes in rates were less synchronized, indicating that more idiosyncratic factors were in play. This was not the case for German and US 10-year rates, as they continued to slide lower in tandem. The 10-year Japanese rate broke from the pack, due mainly to policy adjustments made last month by the Bank of Japan. Among other measures, the Japanese central bank announced a wider bandwidth for the 10-year government bond yield.
- > Yields in peripheral markets such as Spain, Portugal, Italy and Greece were pressured higher. The higher risk premiums demanded to hold peripheral paper is a consequence of developments in Italy, where uncertainty remains about the new government's policies. The move higher of 10-year UK rates coincided with an appreciating sterling, and is almost certainly related to the news flow regarding Brexit.
- > When one looks at the global growth and inflation surprises, it is becoming clear that rates reacted to softer momentum in both growth and inflation. Most equities markets reacted accordingly to this faltering of macroeconomic momentum.
- > The exception is the US equity market, whose resilience is fueled by tax cuts. Given that the second-quarter GDP figure came in at 4.2% QoQ, the impact on the broader economy is undeniable. The bond market, however, questions whether this is sustainable.

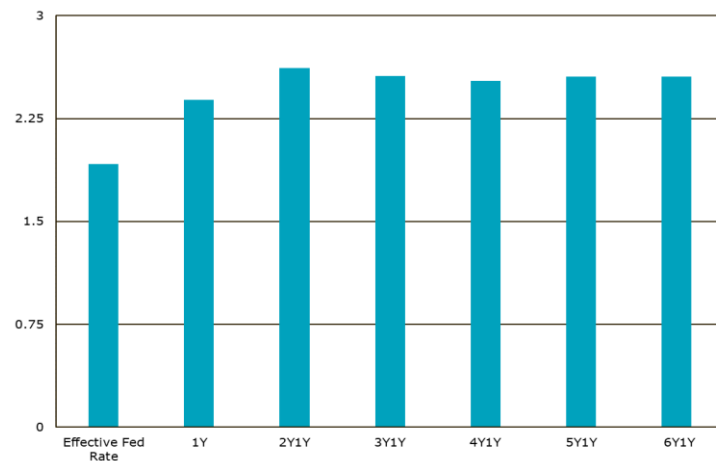
> AAA Bonds (II)

Labor markets are getting tighter globally



Source: Haver & Nomura

Market think rates will peak below the Fed's long-term neutral rate

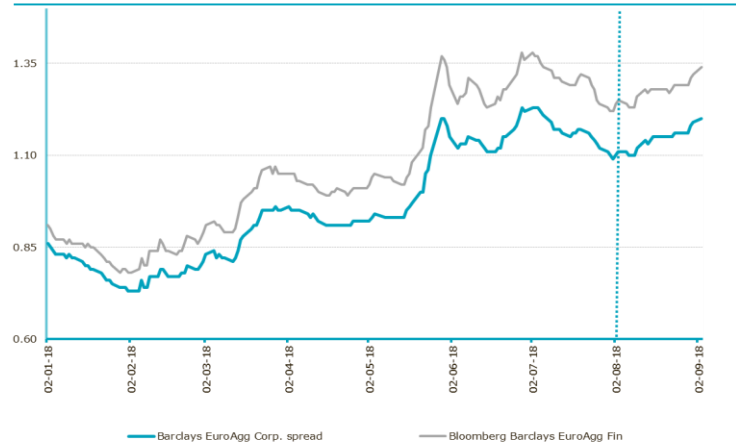


Source: Source: Bloomberg & Robeco

- > While we tend to agree with this view, we are also witnessing some developments that strengthen our belief that inflationary pressures are slowly building. This is not just happening in the US; labor markets are getting tighter globally. We also continue to see leading wage indicators pointing to higher wages in both the euro area and the US.
- > We continue to think that global rates in general will follow the yield path of the US. While the latest minutes of the US Federal Reserve revealed that the central bank remains upbeat on growth and is confident that its inflation target will be reached. It also is apparent that its preference is to err on the side of caution and go easy.
- > More hawkish were Fed Chairman Jerome Powell's remarks at the annual central bankers conference in Jackson Hole. There he indicated that when inflation is low, the Fed's preference is to keep monetary policy rates relatively low, which tends to boost financial assets. He said: "Whatever the cause, in the run-up to the past two recessions, destabilizing excesses appeared mainly in financial markets rather than in inflation. Thus, risk management suggests looking beyond inflation for signs of excesses."
- > In general, our decision to move to a more neutral stance on developed market rates has turned out to have been a good one. However, we still believe that we haven't seen the highs in rates yet.

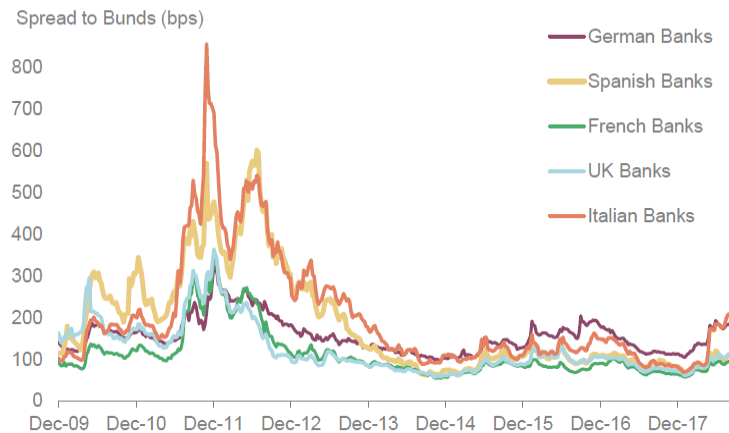
> Investment Grade Credits (I)

European spreads gently move higher



Source: Bloomberg, Robeco

Italian and German bank spreads have risen



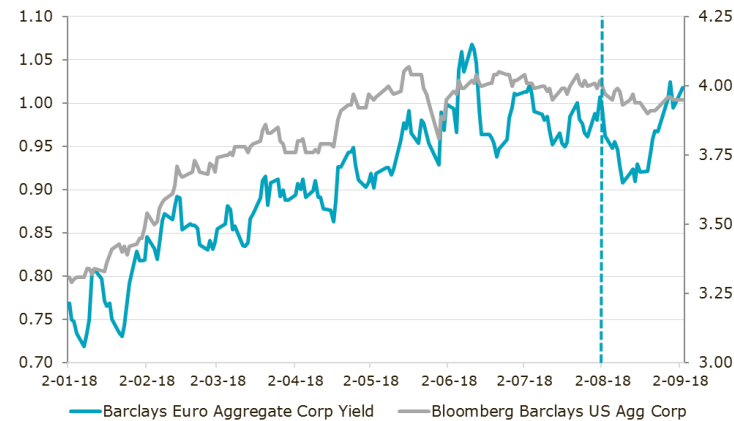
Source: Markit, Morgan Stanley Research

- > For most people, August is the holiday month. The same can be said for European credit markets. There is structurally less corporate issuance, and other activity is also very low. Any movement in the market is therefore the result of wider events. European spreads widened in August, after political risks in Europe rose. The Italian government’s budget plans and its stance towards EU budget rules made investors more cautious. European spreads ended up around 10 bps higher at 1.21 for both the broad index and financials. The widening was caused by both higher yields as well as a falling government bond yield.
- > An Italian government with a loose stance towards budget discipline is immediately a worry for investors in (Italian) financials. Although still low in an historical perspective, we saw spreads of Italian banks (and German banks, as their exposure is relatively high) jump, whereas spreads other countries’ banks hardly moved. Some clarity on the direction in which Italy is heading might ease spread widening.
- > Besides the political risk, there are other reasons why we expect spreads to widen further in the coming months. Heavy issuance is expected in the short term, and together with the further reduction of the CSPP program in the remainder of this year, markets may have more to digest than they can absorb. This could also lead to higher spreads. The underlying European economy is still healthy, but other factors are more important to be cautious on European credits.



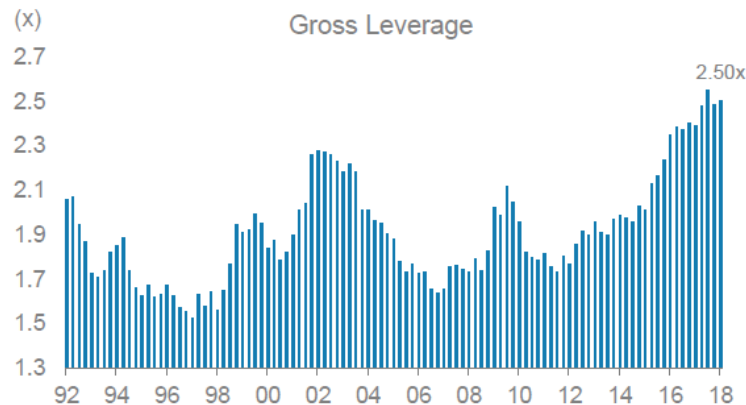
## > Investment Grade Credits (II)

**Yields jump in in Europe, but not in the US**



Source: Bloomberg, Robeco

**Leverage is still at record levels**

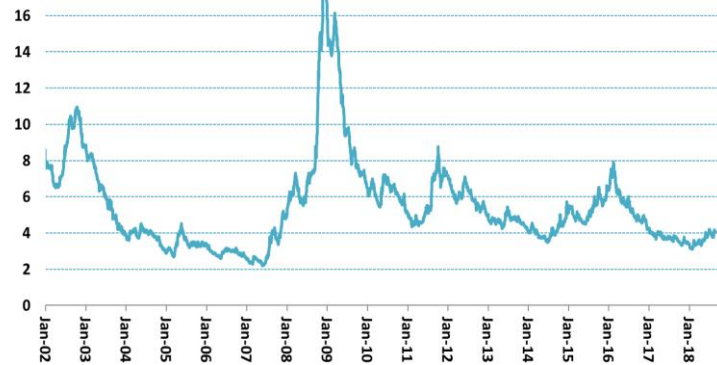


Source: Morgan Stanley, Bloomberg

- > Tweets by President Trump might give you the impression that political risks are also present in the US, but this risk factor hardly plays a role in the American economy. Whereas European yields jumped on increased risks, the US credit yield has been almost flat for a while now. The same holds for the spread, which also didn't move last month.
- > Before the summer, the trade dispute between the US and the rest of world seemed to be a serious issue which would be harmful for corporate America, but it had less influence than expected. The underlying US economy is still doing fine and is a strong basis for credits. However, the risks we assessed earlier haven't gone away in recent months. Leverage is at high levels, credit duration has risen, and the overall credit quality has come down. For foreign investors, it is relatively expensive to hedge the currency risks, which has already caused some withdrawals.
- > Over the summer, we reduced our position in credits to neutral. The risks for credits increased and the prior overweight position was for more technical reasons anyway. For multiple reasons, we expect spreads to widen further in the coming months, which puts pressure on the returns of European credits. Despite the risks that accompany US credits, we think they are becoming more attractive relative to European credits. Within our neutral credit position, we are looking for opportunities outside Europe, where the US is of course the most important market.

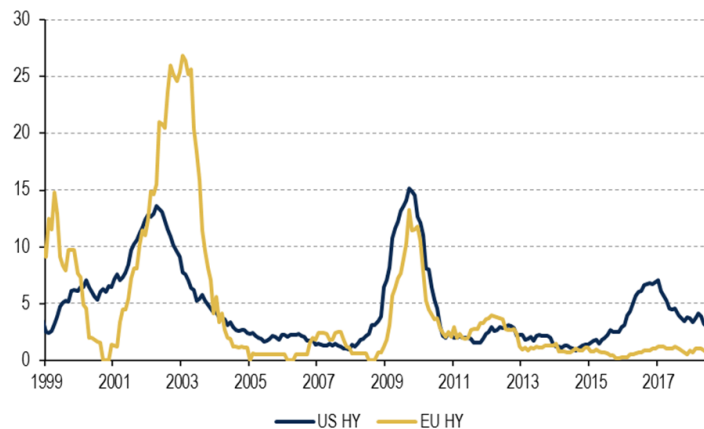
> High Yield (I)

High yield – spread



Source: Bloomberg

High yield – defaults



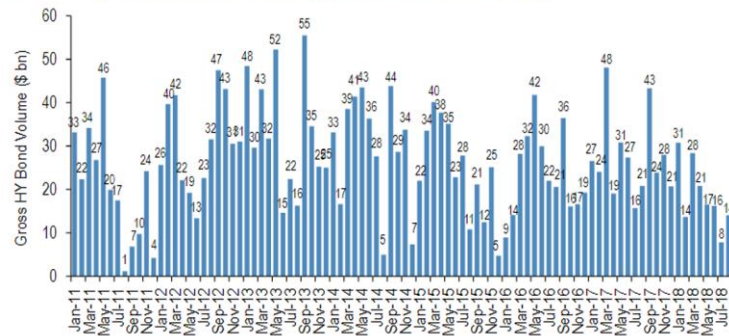
Source: BofA Merrill Lynch

- > After July, in which prices of high yield bonds went up significantly, reclaiming some of the losses incurred since the start of this year, August was another down-month for high yield, with a realized return of -1.1%. Although not as bad as the return on emerging market debt, high yield again lagged developed market corporate and government bonds. At the end of August, the average spread on high yield bonds was 402 basis points, up more than 20 basis points from the end of July. We continue to be underweight high yield bonds, but have also become less negative on the asset class, as some technicals and fundamentals have improved.
- > Unchanged from previous months, the global economy continues to be in a healthy shape. The US, which represents more than 60% of the high yield bond universe, is performing well, with annualized growth of over 4%. Combined with still relatively low interest rates, this resulted in a further decline in the US default rate. Defaults have fallen to the lowest level since late 2015. In Europe, where average high yield bond ratings are higher, the default rate stayed near zero. Given the current economic outlook, we expect default rates to stay low, or come down a bit further in case of the US.
- > Even in the US, interest rates remain relatively low, though we expect them to rise gradually. Given the pace of earnings growth and the debt distribution (maturity wall) that looks pretty benign, we don't expect rising yields to lead to a string of defaults.

> High Yield (II)

High yield – issuance

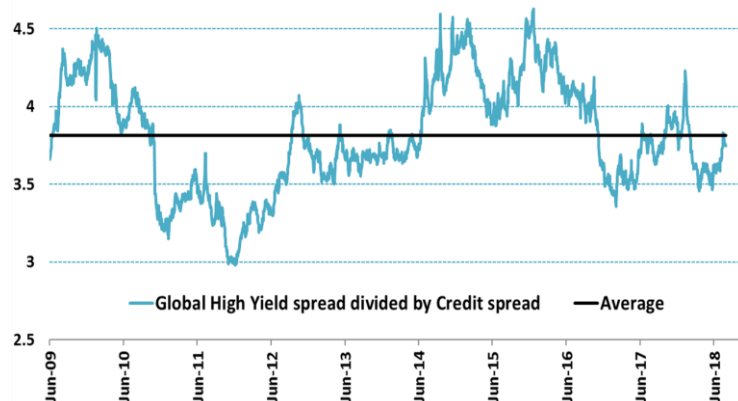
Figure 1: High-yield bond issuance totaling \$148bn YTD is down 30% y/y



Source: J.P. Morgan

Source: J.P. Morgan

High yield – relative valuation against credits

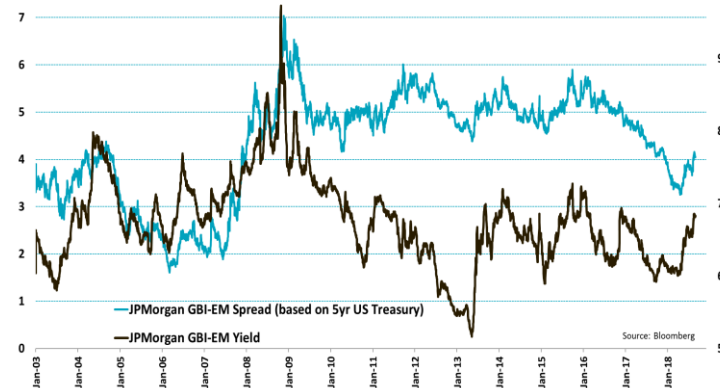


Source: Bloomberg

- > Less impressive is the fact that the weight of covenant-lite loans has increased over time. As their quality is low, their vulnerability to adverse events or market circumstances is high. While we don't see an immediate trigger apart from an overall decline in sentiment, more focus on the quality of loans could lead to elevated volatility.
- > High yield bonds issuance has declined this year, resulting in a more attractive balance between demand and supply.
- > Valuation has been the single most important reason for our negative stance on high yield bonds. However, here too, things have improved somewhat. The yield on local currency emerging debt also increased, but this came with a massive surge in volatility. Compared to equities and credits, valuation in high yield looks less stretched than a couple of months ago. In fact, the relative spread level of high yield over credits has moved up to the long-term average. In Europe, however, equities still look more attractive.
- > We remain underweight high yield bonds, but have become more constructive over the last month. From an economic viewpoint, things look pretty OK, even though we are late cycle. Technicals seem to have improved somewhat. Valuation is still a negative, but less so than it was a couple of months ago.

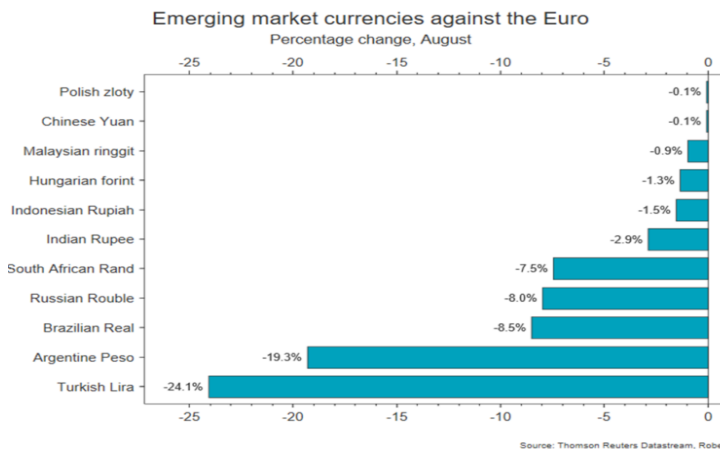
> Emerging Market Debt (I)

Emerging market debt in local currency – spread and yield



Source: Bloomberg

Emerging currencies



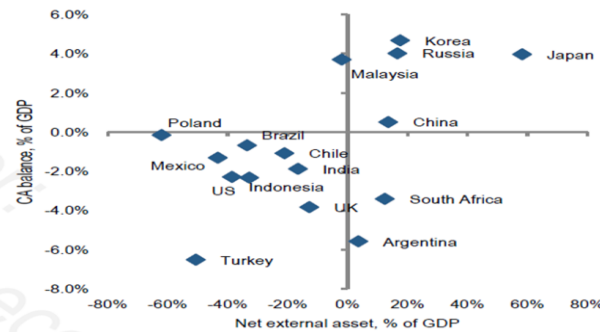
Source: Thomson Reuters

- > It was another pretty dreadful month for local currency emerging market debt. The asset class realized a negative return of 3.6% in August, one of its worst months since the JPMorgan GBI-EM Global Diversified Composite Index was launched back in 2003.
- > Turkey’s troubles were a very important explanatory factor for the poor performance of local currency emerging market debt. First, the Turkish lira fell 24%(!) against the euro, while the yield on 10-year Turkish government bonds spiked to above 20%. Second, there were clear sentiment-driven spillover effects to the currencies of countries that share some, but not all, of Turkey’s characteristics. South Africa is the most important example of this, along with Russia and Brazil, whose currencies also fell sharply against the euro. Argentina, which is not incorporated in the index, also tanked.
- > The worst is probably not over for Turkey. This is partly because the country’s government and central bank have so far refrained from the orthodox reaction to a currency crisis, which is to raise short-term interest rates. Several measures have been implemented, such as more liquidity for banks and increasing the cost of betting against the lira, but it’s unlikely they will be effective. Next to that, the impact on GDP growth (a recession is likely), on inflation (it will rise sharply from an already elevated level) and on bank reserves (many bank and corporate bank loans are denominated in foreign currency) has yet to become visible. This will take time, but Turkey faces harsh times.

> Emerging Market Debt (II)

Foreign positions

Figure 2: Turkey has one of the highest net external debt and current account deficit (% of GDP)



Source: Thomson Reuters, Credit Suisse research

Valuation versus high yield bonds

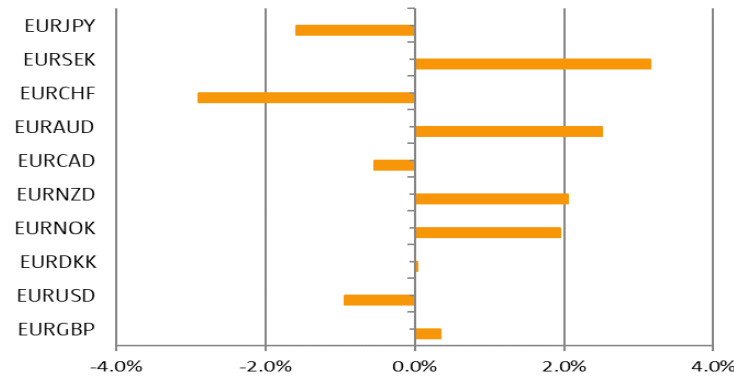


Source: Bloomberg

- > Turkey’s troubles should not be extrapolated too far, however. As the chart on the top left shows, Turkey has both a high percentage of external debt, and a high current account deficit, meaning money has to flow in from abroad. Historically, this combination has led to currency crises before. But the chart also shows that none of the major emerging market countries in the EMD index share the same problematic combination of high foreign debt and current account balances.
- > In addition, Turkey’s weight in the index has decreased considerably over the last year or so. It still has a weight of 3.4%, but that’s down dramatically from the maximum of 10% it had for a long time.
- > We have decided to stay neutral on local currency emerging market debt for now. First, we already have a negative stance on emerging markets through equities. Second, because of the severe downturn in other emerging market currencies, as a result of spillovers from Turkey, some of the other countries are starting to look cheap. Turkey represents a relatively small weight in global GDP, has limited direct economic and trade ties with other countries, and is an outlier on the combination of high external debt and the current account balances. We therefore believe that the chances of an emerging market crisis are small, albeit not zero. While this does not necessarily mean that the worst is over, it does mean that the risk to the upside and downside has become more balanced. We do stay underweight emerging market equities, however.

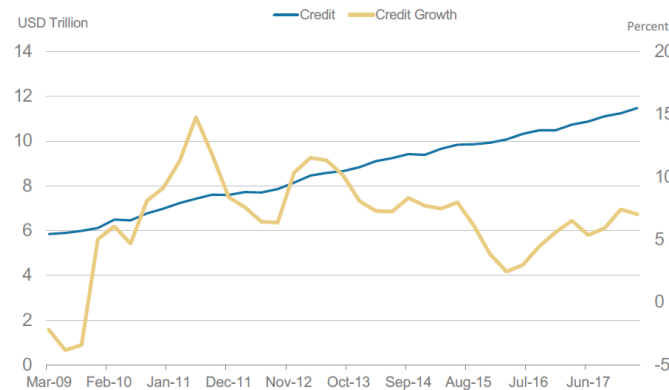
> FX (I)

**G-10 currencies: safe haven currencies did well in August**



Source: Bloomberg, Robeco

**USD-denominated debt owned by foreign banks that needs to be funded**



Source: BIS, Morgan Stanley

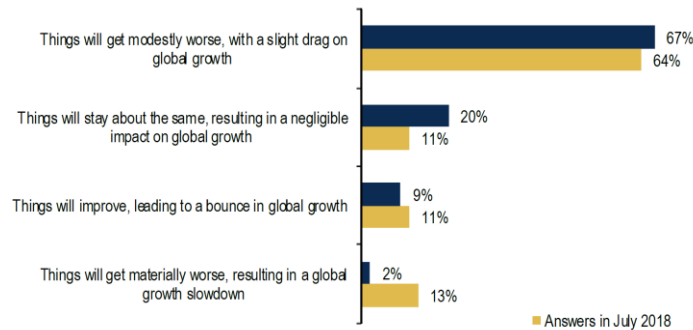
- > In August, the Swiss franc appreciated the most within G-10. The euro ended in the middle of the pack, which should be considered a decent performance given that at one point in August, the euro/dollar exchange rate touched 1.1342, the lowest point of the year. The big losers were the Swedish krona and Australian dollar.
- > The currencies that did well in August are those which are frequently referred to as the safe haven currencies (JPY, USD and CHF). The laggards within G-10 were currencies that are most effected by geopolitical and trade developments. The surprise here was the sudden increase in domestic political tensions in Sweden and Australia, which negatively effected these currencies.
- > In our view, the currency markets are stuck between geopolitical tensions and the tightening of liquidity. While the US can be seen as the main instigator of these developments, it is currently still the region least effected by these forces.
- > Not only is growth holding up nicely, but US financial markets are steadily continuing their ascent. Other regions, however, are not that lucky. Emerging markets, for instance, are currently bearing the brunt of the pain.



> FX (II)

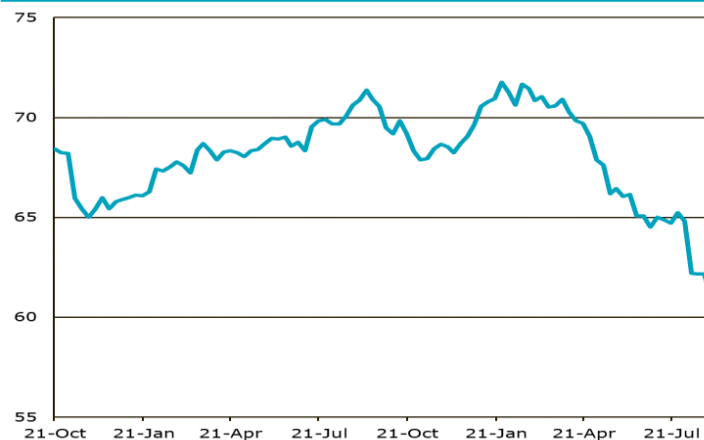
**Worries about trade eased slightly but remain elevated**

**My expectations for trade tensions are:**



Source: BofA Merrill Lynch Global Research

**JP Morgan Emerging Market FX index: bearing the brunt of the pain**



Source: Robeco & Bloomberg

- > One of the reasons why the US has been sheltered from the effects of tightening by the Fed so far is probably the repricing of emerging markets that is taking place and the money flight that accompanies it. It is highly likely that the money leaving the emerging markets is finding a new home in the US.
- > Beside the Fed tightening, we continue to have to deal with the uncertainty with regards to trade. Every time you think that the US and its trading partners (or maybe adversaries is a better term these days) have come to a point where differences seems to be resolved, Trump sends out a tweet that puts everything back on the table.
- > As we head towards the US mid-term Congressional elections, we need to start thinking about what strategy Trump thinks will deliver him a victory. Is it the one that confirms his image as the dealmaker, or is the one that boosts his anti-establishment credentials? We currently have no clue what it will be, but given recent developments between Mexico and the US, we are hopeful that Trump prefers to go for the former. As we think the easy deals are the ones that can be cut with Canada and the EU, there is upside potential for the currencies.
- > We currently hold no currency positions. In August, we closed our long USD/short EUR position after Trump started to complain about the monetary policy of the Fed, which put a (temporary) halt to the gradual appreciation of the dollar.

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