ROBECO
The Investment Engineers

Multi-asset market outlook

Will EM assets breathe some fire in the Year of the Dragon?

July 2024

General overview

Emerging markets returns showing signs of life

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Oil Index (USD)	6.8%	1.3%	19.8%	28.8%	16.2%	0.0%
Emerging Markets (UH, EUR)	5.3%	5.8%	10.8%	14.6%	-1.8%	4.4%
Emerging Markets (LC)	4.3%	6.2%	11.0%	15.5%	-1.6%	5.6%
MSCI World (UH, EUR)	3.4%	3.4%	15.2%	22.4%	10.5%	13.1%
GSCI Commodities (USD)	2.7%	1.4%	14.5%	17.1%	16.6%	9.6%
Global real estate (UH, EUR)	2.7%	-1.5%	2.7%	9.8%	1.1%	2.1%
MSCI World local currency	2.3%	3.0%	13.4%	21.3%	8.4%	12.5%
MSCI World (H, EUR)	2.3%	2.8%	13.0%	19.8%	6.7%	10.8%
EMD hard currency (UH, EUR)	1.7%	1.3%	5.0%	9.8%	0.5%	1.2%
Global Gov Bonds (H, EUR)	0.7%	-0.8%	-1.6%	0.6%	-4.4%	-2.2%
EMD local currency (UH, EUR)	0.7%	-1.2%	-1.1%	2.6%	0.4%	0.5%
Global investment grade bonds (H, EUR)	0.6%	-0.2%	-0.5%	4.2%	-4.0%	-1.0%
Global high yield (H, EUR)	0.5%	0.8%	3.1%	10.5%	-0.5%	1.2%
Cash (EUR)	0.3%	1.0%	2.0%	4.0%	1.7%	0.8%
Global inflation-linked bonds (H, EUR)	0.2%	-0.8%	-1.7%	0.1%	-5.3%	-1.8%
Gold (USD)	0.1%	4.9%	12.7%	20.6%	9.1%	9.4%

Source: Robeco, Bloomberg

In the first half of 2024, the S&P 500 (the largest global stock market) hit all-time highs 31 times, showing the resilience and momentum in US equities. More broadly, risk assets finished Q2 strongly, with parts of the commodities space outperforming, and emerging market equities continued their recent trend by outperforming global equities in June and over the second quarter.

Within fixed income, the outcome was the opposite, as 'safe haven' bonds outperformed the more volatile parts of fixed income markets, which partially reversed the quarterly trend of high yield outperforming investment grade and government bonds.

Gold and inflation-linked bonds lagged in June as the disinflation trend continued in Europe and US, though gold is still up strongly in the year to date.

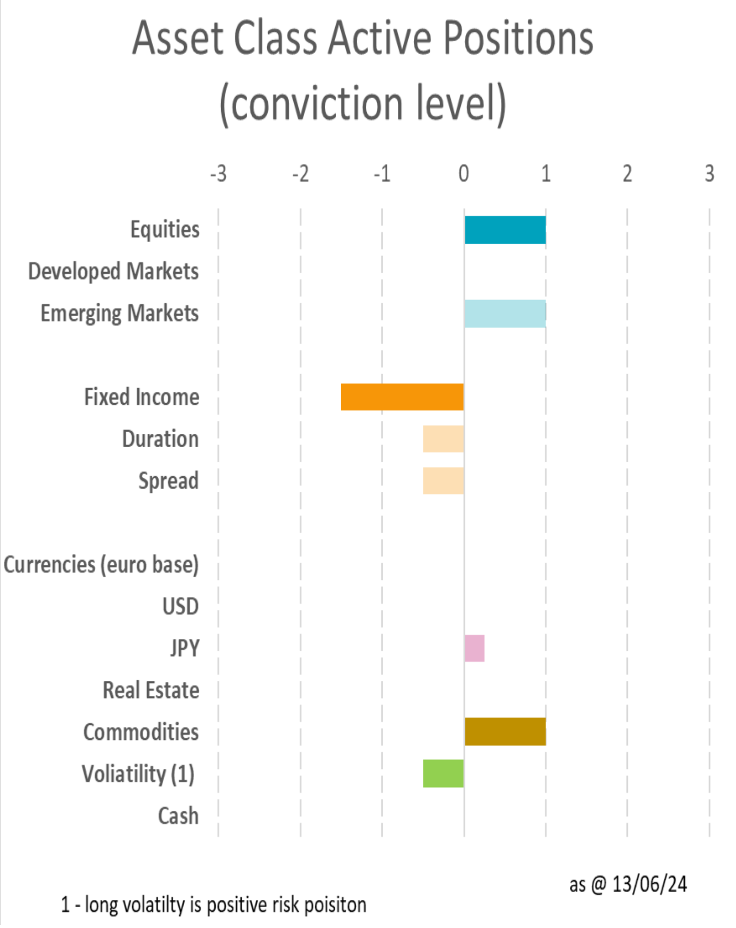
Within emerging market equities, South Korea benefited from the halo effect of the semiconductor cycle and cheap valuations, while India saw renewed investor interest as pre-election uncertainty was priced out. The standout returns were the equity and bond markets for South Africa, where the post-election dust settled with a governing coalition between the ANC and Democratic Alliance (DA), reducing the tail risk of a negative outcome for investors.

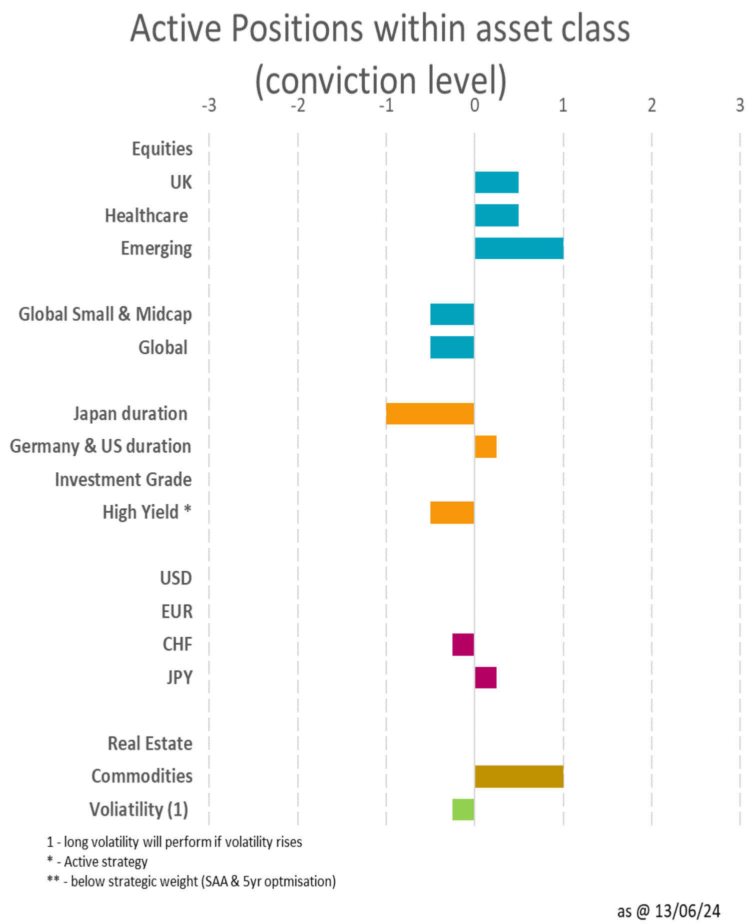
The snap election called by President Macron of France injected volatility into Eurozone government bonds, as investors flocked to German bunds (safe haven) and let French OAT spreads jump wider.

 All market data to 30 June 2024 unless mentioned otherwise

Robeco Multi Asset views

Sustainable Multi Asset Solutions positions





Source: Robeco

The multi-asset portfolios did not keep up with benchmarks in June, as active stock selection gave back some of the outperformance in May. We have used the volatility in markets to change the asset allocation and have increased our high conviction views.

Firstly, we moved to an overweight in equities as the opportunity to close our underweight to Eurozone equities arrived. The catalyst was the announcement of a snap French election which sent French banks tumbling by close to 20%, while French bond spreads soared against German Bunds. In addition, we removed our long euro position against the Swiss franc as safe haven flows overwhelmed the interest differentials following surprise rate cuts by the Swiss National Bank (SNB). We did not reduce our equity longs as the US equity market dynamics remain very positive due to earnings and the AI storytelling.

Secondly, we went long commodities again as the technical mispricing reverted and the OPEC+ meeting delivered no surprises.

Lastly, following the ECB rates cuts and the softer data in the US, we added some sovereign bonds curve trades and relative value views (Canada vs. the US), resulting in a slight long duration position in portfolios.

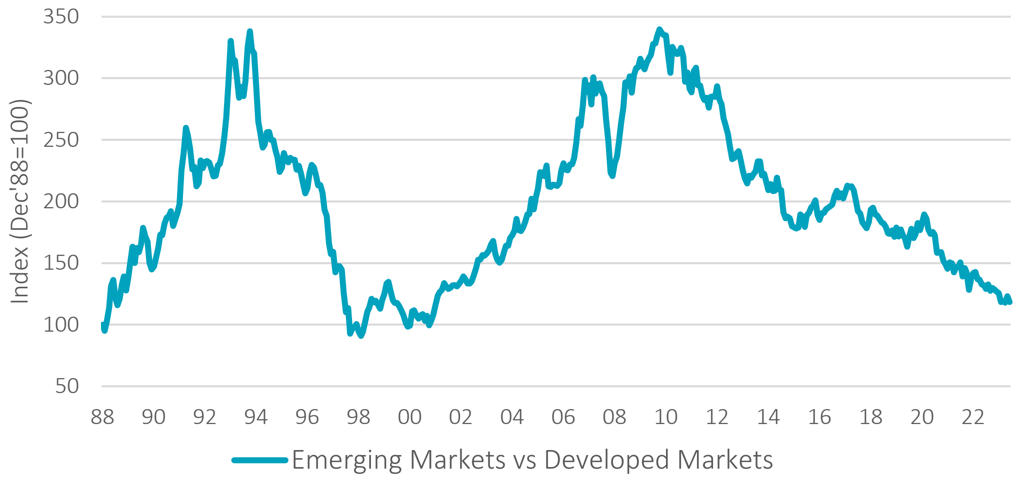
Theme of the month

Will the Dragon soar? What's in store for EM assets for the rest of 2024?

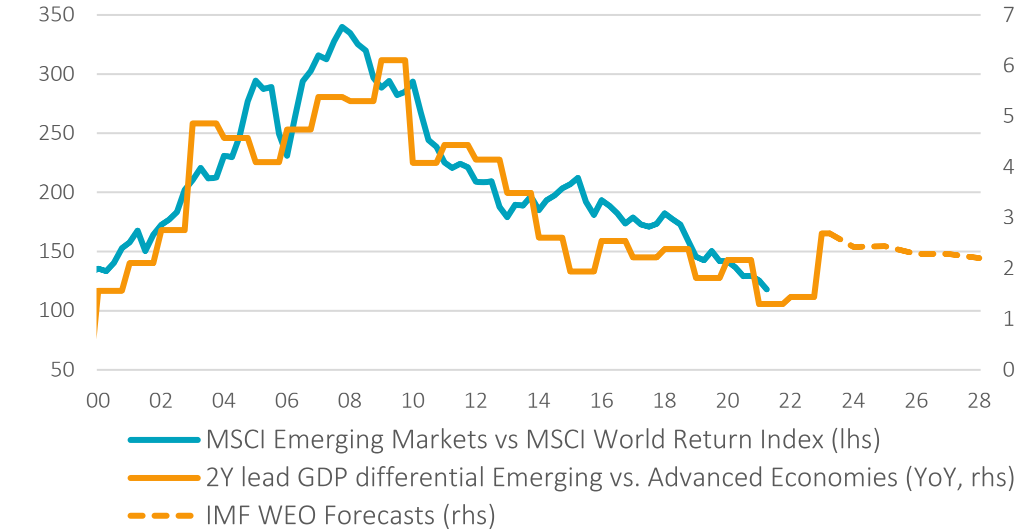
Despite the better economic growth rates for emerging market economies over the past decade, emerging market assets have failed to deliver meaningful outperformance across the equity, fixed income and FX spectrums. To put that into perspective, annualised returns for EM equities over the 10-year period to the end of June 2024 have lagged developed markets by 7% a year. A stronger dollar has also led to weaker EM currency performance of as much as 6% less per year, based on the relative return of the JPM Emerging Market Currency Index versus the dollar. In the fixed income space, yields of 6.6% for the GBI-EM Global Diversified Local Currency index are well above the 3.4% on offer for Global Developed Governments, although recently the gap between the two has been closing, as central banks around the world have been in a rate-hiking mode over the last year.

Catalysts on whether the Year of the Dragon will prove to be the turning point for emerging market assets could play out over the course of the second half of 2024, providing a more supportive backdrop for future performance. Growth differentials between emerging and developed markets have historically led to better EM vs. DM equity performance, with the recent reversal to more positive levels seen as a prospective supportive factor for EM stocks. Tactically, the behaviour of the dollar will also be an important driver for emerging market assets, be it equities or fixed income. As the Fed embarks on a rate-cutting cycle, the prospect for more gradual and less steep rate cuts over the next 12 months amid a benign global economic environment would bode well for emerging market asset performance. In the meantime, the trajectory and speed of inflation moving to more sustainable levels (of 2%) would pave the way for more accommodative policies, in a period when the focus remains on elections (particularly in the US) that have the potential to ignite short-term volatility and create opportunities within the EM space.

Emerging vs. Developed Markets Total Return Index



Emerging vs. developed markets and GDP growth differential



Source: Robeco, Bloomberg, Refinitiv Eikon, IMF WEO. Data to May 2024.

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Theme of the month

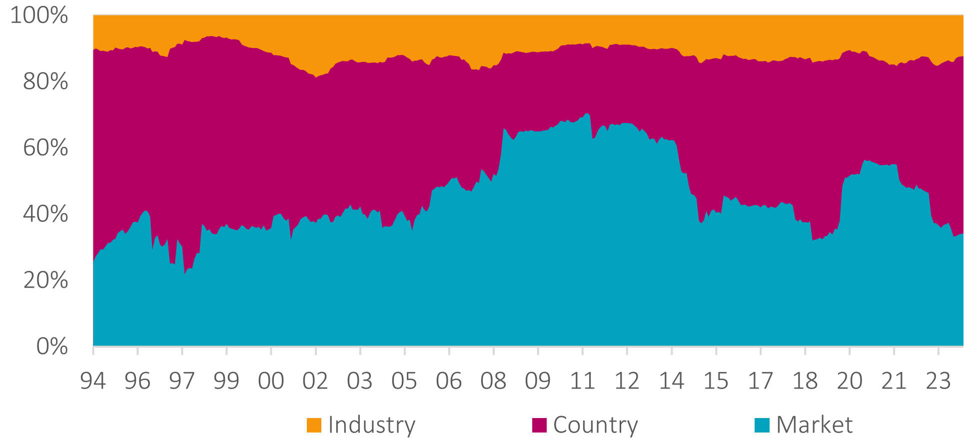
Differentiating across countries is key to achieving a better balance (I)

Historically, an active approach in emerging markets has been supported not only by liquidity and market breadth considerations, but also by the higher impact of country selection on the volatility of EM returns, as least within the equity space. This is at odds with developed markets, where the contribution of industry factor effects has been a more prominent driver of equity volatility.

Notably, the regional divergence in the performance of China, which dominates the EM equity index with a 25% weight in the MSCI EM, and EM ex-China exposures has played a key role both in terms of risk and return perspective, and is likely to continue to do so. The performance differential between Chinese and EM ex China-equities since the Covid years has almost reached 50%, which can be partly attributed to domestic drivers, as the Chinese property market has faced significant headwinds. But it is also due to market structure differences, as the China equity index is significantly underexposed (5.9% vs. 31.5% for the MSCI EM-China index) to the Technology sector, one of the biggest beneficiaries of the AI boom. From a risk perspective, the convergence of EM vs. DM volatility over the last year has created a more favourable profile for emerging equities. The EM ex-China equity correlation is now higher versus developed markets like the US and Europe (close to 70% over the last 12 months) and lower versus China (56%). This changing correlation dynamic within the EM universe is reflective of the varying degrees of diversification of these exposures in global equity portfolios.

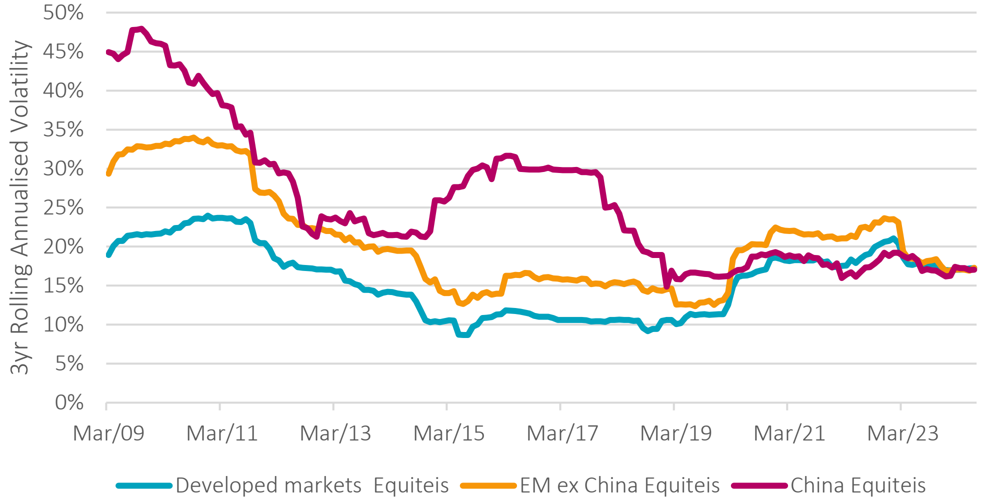
Looking ahead, the valuation argument for EM relative to DM equities as a whole remains compelling, with EM ex-China trading at a 25% forward discount, while the 40% discount of Chinese equities vs. DM stands close to its 20-year historical low. Arguably, the case for attractive relative returns over the medium term is strong, while the recent turn of the global manufacturing cycle – global PMI surveys have risen above 50 since the beginning of the year – could provide a more positive backdrop for earnings. This is particularly true in export-oriented economies with a large manufacturing base, which are better positioned to benefit from an improving global growth outlook.

Emerging market factor contributions to volatility of returns



Source: Robeco, Bloomberg, Refinitiv Eikon. Data to May-2024.

3-year rolling volatility of emerging vs. developed markets



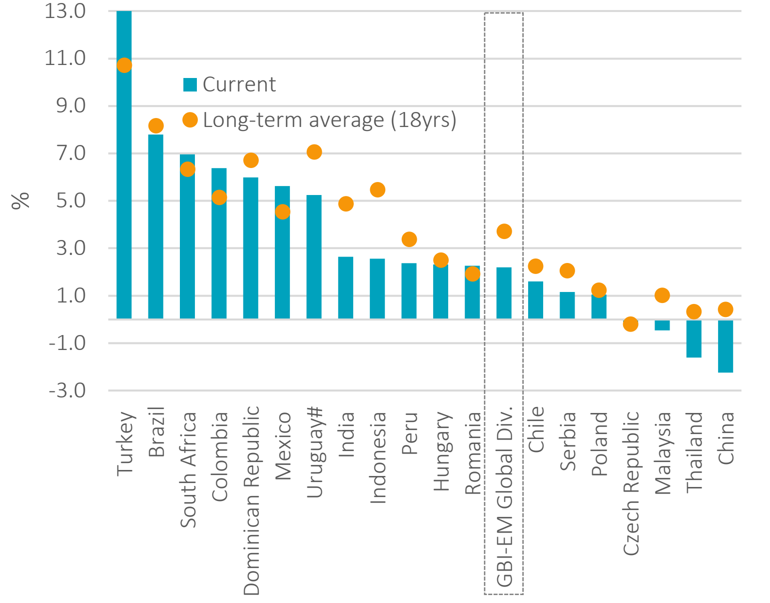
Source: Robeco, Bloomberg. Data to 30 June 2024.

Theme of the month

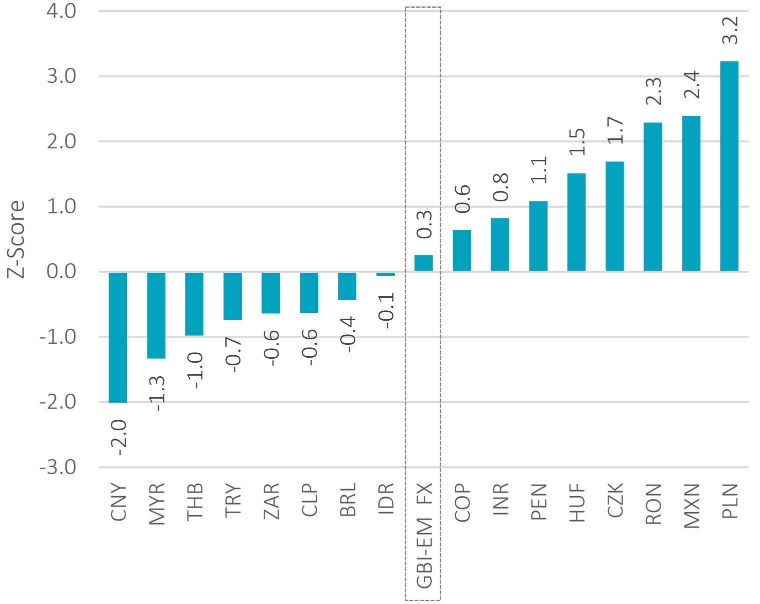
Differentiating across countries is key to achieving a better balance (II)

At the other end of the spectrum, the balance of risks in EM fixed income assets lies in the speed and magnitude of central bank policy shifts towards a more accommodative stance. The US is unequivocally in the driving seat and is setting the tone in terms of the overall attractiveness of EM local currency debt. Despite the higher yield of the EM local currency bond index, the pivot to a lower rate environment in the US would be key for the asset class's performance for the rest of the year. Meanwhile, the average spread of EM local rates vs. US Treasury yields (2.2% at June 2024 vs. 3.7% for the long-term (18 years) average spread of the GBI-EM Global diversified index) is lower than the historical average. This highlights the need to be selective over the coming months, and favour countries where carry opportunities are enough to compensate for short-term uncertainty, a likely slower disinflationary trend, and potentially higher premia due to the upcoming US election. In a similar vein, as currency volatility (based on the JP Morgan 1-month FX volatility index) has been relatively subdued since the start of the year, cheaper and under-owned currencies should fare better relative to the dollar as interest rate differentials normalise in line with the future pace and timing of rate cuts.

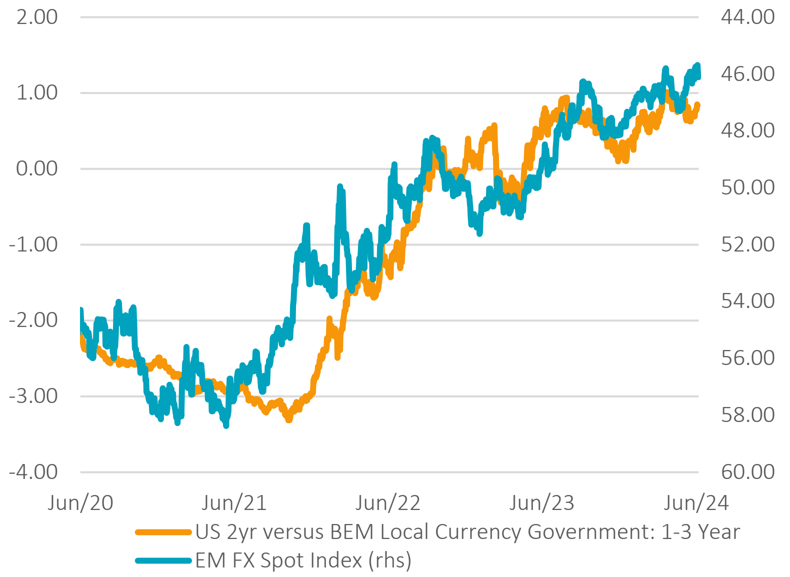
Yield to Maturity vs. 10-year US Treasury



BIS Real Effective Exchange rate (Z-Score)



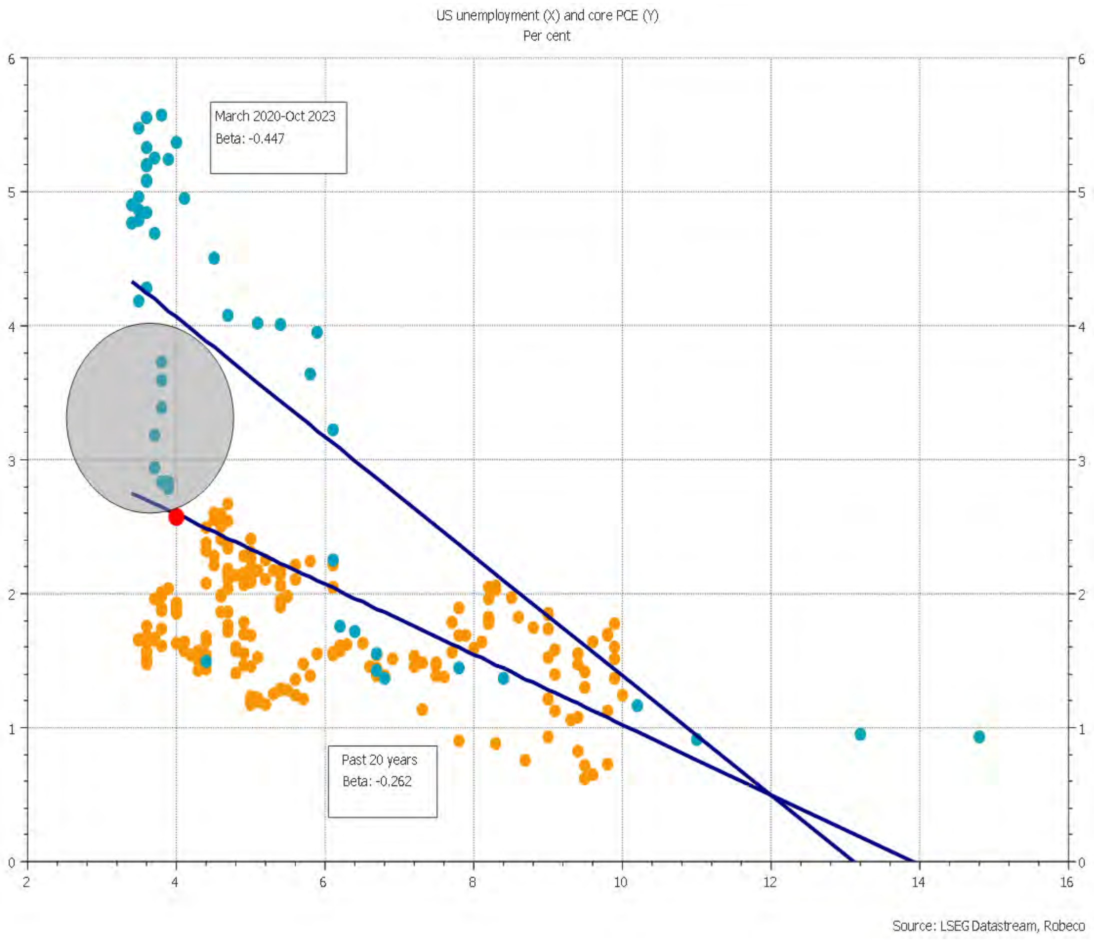
EM FX vs. US and EM rate differential



Source: Robeco, Bloomberg. Data to 30 June 2024.

Economy

Now for the hard part as we just landed on the old Phillips curve…



Source: Refinitiv Datastream, Robeco

All market data to 30 June 2024 unless mentioned otherwise.

As we enter the second half of 2024, macroeconomic volatility is picking up as business cyclicality – a hesitant start to the DM central bank cutting cycle, rebounding local housing markets and credit demand in Europe – clashes with politics in the US and the snap French elections. So far, we have seen the impact of negative externalities dominate the recent soft macro data in the US and core Europe through the confidence channel, as fiscal sustainability issues have come to the fore again. The G10 macroeconomic surprise index has declined and become negative on the back of disappointments in leading manufacturing indicators in both the US as well as in Europe.

The further decline in the June ISM manufacturing employment index into contraction territory, the steady rise in continuing jobless claims to 1.86 million in June (the highest since November 2021), and lower job openings suggests the US labor market maybe close to an inflection point, where any further cooling might lead unemployment higher. From a growth level perspective, US growth for Q2 is trending lower, with the Atlanta Fed nowcast for Q2 at 1.5% on the back of subdued real consumption growth (1.5%).

Meanwhile, Europe seemed to have rediscovered its mojo had it not been for French President Macron calling snap elections on 9 June. At the time of writing, we are still awaiting the decisive second election round, but so far polls indicate the French government seems to be heading towards a gridlock situation, with a lame duck Macron having to cohabitate with the right-wing National Rally in the coming years. As a result, France – which has outperformed Germany under Macron when it comes to economic performance – now faces stalling reforms.

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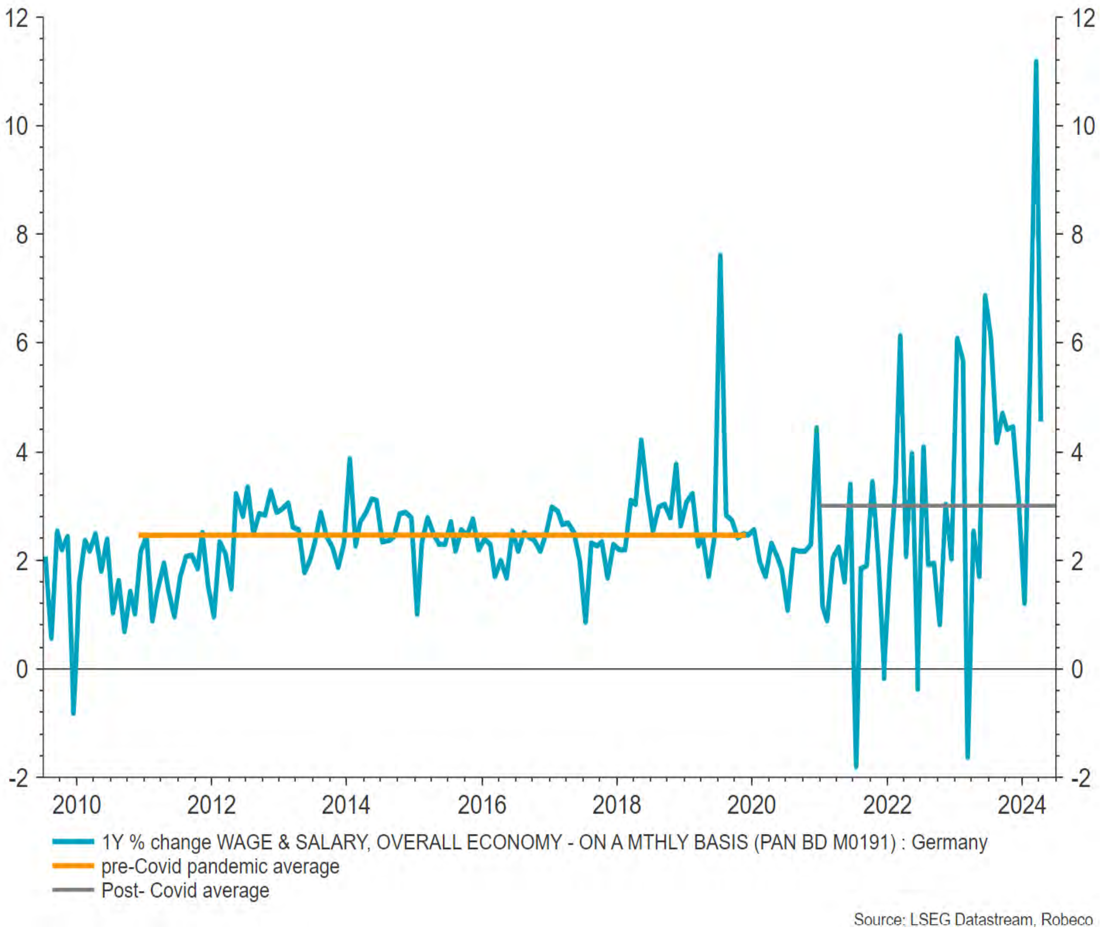
Economy

German wage growth is settling on a higher plane



Source: Refinitiv Datastream, Robeco

In China, PMI data from smaller, more export-oriented companies came in stronger in June, with the Caixin PMI showing increasing expansion, notably on increased output. Delivery times improved in a similar way to developed markets. Nonetheless, an increasing probability of a Trump presidency after the disastrous Biden TV debate performance could lead to frontloading of orders and restocking from Western corporates to temporarily boost Chinese export demand.

Yet, the broader NBS manufacturing survey which is more tilted to large caps and state companies still remained in contraction. Broad money growth in China is still contracting (y-o-y), hinting at deleveraging pressures, with domestic consumption still inhibited by the ongoing malaise in residential housing. Judging by historical precedents (US, Spanish housing bubble bursts), we are still 2-3 years away from a cycle trough. The NBS average new house price in 70 Chinese cities declined by 0.7% m-o-m over May. Therefore, more piecemeal stimulus to counteract the ongoing drag from the housing market is to be expected.

In Europe, it will be interesting to see to what extent the bargaining power of unions holds up now that the post-Covid inflation wave is abating and wage growth catch-up is maturing. The ECB embarked on a rate cutting cycle in June with its first 25 bps cut. Yet, with services inflation sticky at 4.1% in June, the ECB has to remain vigilant not to fuel a smouldering inflationary fire. Metalgesellschaft, German's union for industry workers, has demanded 7% wage increases for the coming pay round. The German industry has by and large already fully caught up with post-Covid inflation with recent wage increases, so another decent raise will establish the higher wage level above 3% (see chart). Against a backdrop of further recovery in consumer demand thanks to real disposable income growth, the leeway for further cuts by the ECB could become more limited towards 2025.

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The funds have not been and will not be registered with the National Registry of Securities or maintained by the Mexican National Banking and Securities Commission and, as a result, may not be offered or sold publicly in Mexico. Robeco and any underwriter or purchaser may offer and sell the funds in Mexico on a private placement basis to Institutional and Accredited Investors, pursuant to Article 8 of the Mexican Securities Market Law.

Additional information for investors with residence or seat in Peru

The Superintendencia del Mercado de Valores (SMV) does not exercise any supervision over this Fund and therefore the management of it. The information the Fund provides to its investors and the other services it provides to them are the sole responsibility of the Administrator. This Prospectus is not for public distribution.

Additional information for investors with residence or seat in Singapore

This document has not been registered with the Monetary Authority of Singapore (“MAS”). Accordingly, this document may not be circulated or distributed directly or indirectly to persons in Singapore other than (i) to an institutional investor under Section 304 of the SFA, (ii) to a relevant person pursuant to Section 305(1), or any person pursuant to Section 305(2), and in accordance with the conditions specified in Section 305, of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. The contents of this document have not been reviewed by the MAS. Any decision to participate in the Fund should be made only after reviewing the sections regarding investment considerations, conflicts of interest, risk factors and the relevant Singapore selling restrictions (as described in the section entitled “Important information for Singapore Investors”) contained in the prospectus. Investors should consult their professional adviser if you are in doubt about the stringent restrictions applicable to the use of this document, regulatory status of the Fund, applicable regulatory protection, associated risks and suitability of the Fund to your objectives. Investors should note that only the Sub-Funds listed in the appendix to the section entitled “Important information for Singapore Investors” of the prospectus (“Sub-Funds”) are available to Singapore investors. The Sub-Funds are notified as restricted foreign schemes under the Securities and Futures Act, Chapter 289 of Singapore (“SFA”) and invoke the exemptions from compliance with prospectus registration requirements pursuant to the exemptions under Section 304 and Section 305 of the SFA. The Sub-Funds are not authorized or recognized by the MAS and shares in the Sub-Funds are not allowed to be offered to the retail public in Singapore. The prospectus of the Fund is not a prospectus as defined in the SFA. Accordingly, statutory liability under the SFA in relation to the content of prospectuses does not apply. The Sub-Funds may only be promoted exclusively to persons who are sufficiently experienced and sophisticated to understand the risks involved in investing in such schemes, and who satisfy certain other criteria provided under Section 304, Section 305 or any other applicable provision of the SFA and the subsidiary legislation enacted thereunder. You should consider carefully whether the investment is suitable for you. Robeco Singapore Private Limited holds a capital markets services license for fund management issued by the MAS and is subject to certain clientele restrictions under such license.

Additional information for investors with residence or seat in Spain

Robeco Institutional Asset Management B.V., Sucursal en España with identification number W0032687F and having its registered office in Madrid at Calle Serrano 47-14º, is registered with the Spanish Commercial Registry in Madrid, in volume 19.957, page 190, section 8, sheet M-351927 and with the National Securities Market Commission (CNMV) in the Official Register of branches of European investment services companies, under number 24. The investment funds or SICAV mentioned in this document are regulated by the corresponding authorities of their country of origin and are registered in the Special Registry of the CNMV of Foreign Collective Investment Institutions marketed in Spain.

Additional information for investors with residence or seat in South Africa

Robeco Institutional Asset Management B.V. is registered and regulated by the Financial Sector Conduct Authority in South Africa.

Additional information for investors with residence or seat in Switzerland

The Fund(s) are domiciled in Luxembourg. This document is exclusively distributed in Switzerland to qualified investors as defined in the Swiss Collective Investment Schemes Act (CISA). This material is distributed by Robeco Switzerland Ltd, postal address: Josefstrasse 218, 8005 Zurich. ACOLIN Fund Services AG, postal address: Leutschenbachstrasse 50, 8050 Zürich, acts as the Swiss representative of the Fund(s). UBS Switzerland AG, Bahnhofstrasse 45, 8001 Zurich, postal address: Europastrasse 2, P.O. Box, CH-8152 Opfikon, acts as the Swiss paying agent. The prospectus, the Key Information Documents (PRIIP), the articles of association, the annual and semi-annual reports of the Fund(s), as well as the list of the purchases and sales which the Fund(s) has undertaken during the financial year, may be obtained, on simple request and free of charge, at the office of the Swiss representative ACOLIN Fund Services AG. The prospectuses are also available via the website.

Additional information for investors with residence or seat in Taiwan

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. This document has been distributed by Robeco Hong Kong Limited ("Robeco"). Robeco is regulated by the Securities and Futures Commission in Hong Kong.

Additional information for investors with residence or seat in Thailand

The Prospectus has not been approved by the Securities and Exchange Commission which takes no responsibility for its contents. No offer to the public to purchase the Shares will be made in Thailand and the Prospectus is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

Additional information for investors with residence or seat in the United Arab Emirates

Some Funds referred to in this marketing material have been registered with the UAE Securities and Commodities Authority ("the Authority"). Details of all Registered Funds can be found on the Authority's website. The Authority assumes no liability for the accuracy of the information set out in this material/document, nor for the failure of any persons engaged in the investment Fund in performing their duties and responsibilities.

Additional information for investors with residence or seat in the United Kingdom

Robeco Institutional Asset Management B.V (FRN: 977582) is authorised and regulated by the Financial Conduct Authority.

Additional information for investors with residence or seat in Uruguay

The sale of the Fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Fund must not be offered or sold to the public in Uruguay, except under circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The Fund is not and will not be registered with the Financial Services Superintendency of the Central Bank of Uruguay. The Fund corresponds to investment funds that are not investment funds regulated by Uruguayan law 16,774 dated 27 September 1996, as amended.