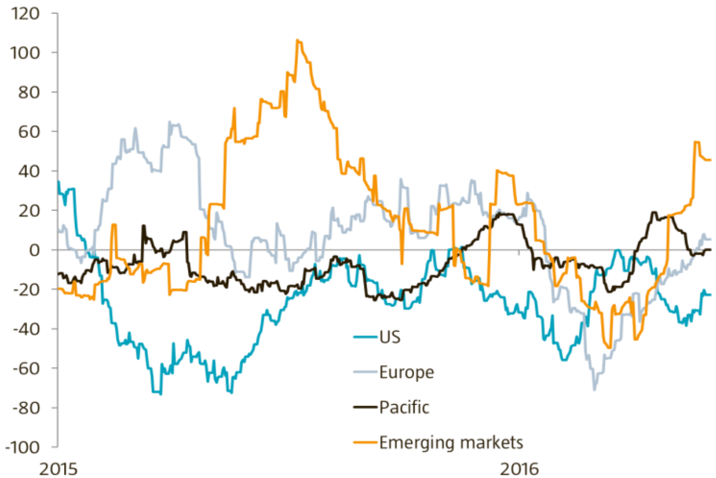
ROBECO

Multi-asset markets outlook

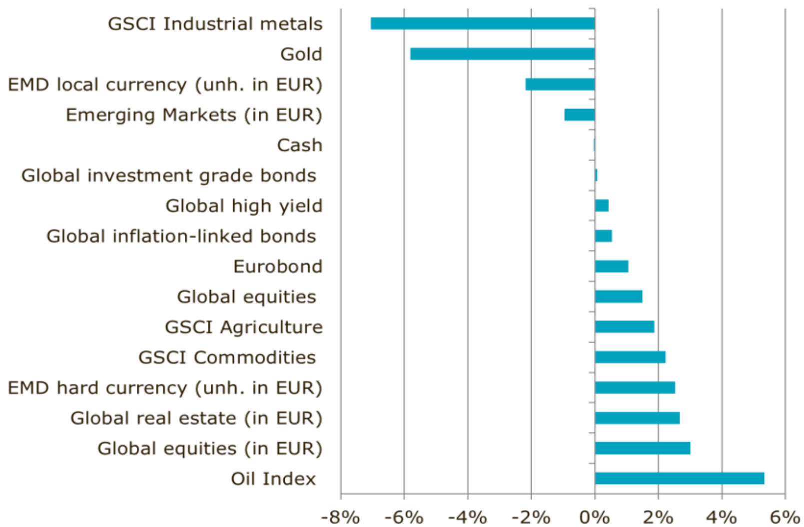
June 2016

General overview

Economy rebounds, but in line with expectations



Risky assets take the lead in May, but not by much



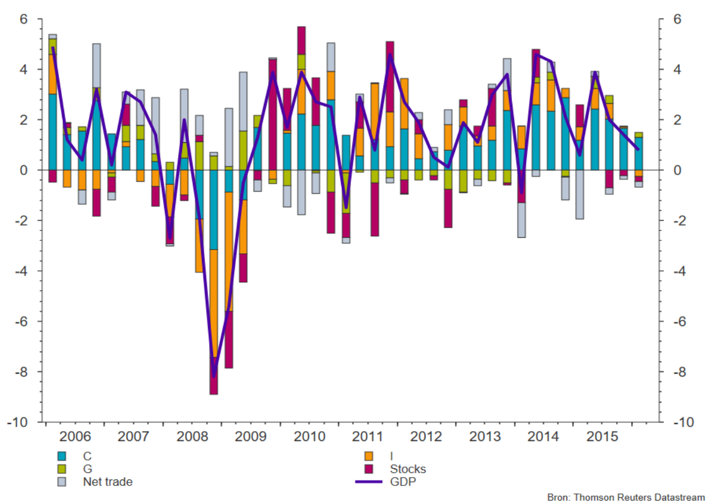
- Q2 is on track to show stronger global economic growth. Following the weak first quarter, it is a quite a relief to see that the US economy is now moving towards a higher growth path in the second quarter, with housing and consumer spending leading the way. Although encouraging, we should point out that, on the whole, published figures have not been better than expected. The Citigroup Economic Surprise Index for the US economy is still in negative territory. The emerging region was the only area that managed to surprise positively on this metric, but this appears to have been mainly due to the very low expectations regarding the growth outlook for this group of countries. All in all, even though the outlook improved, it was generally in line with expectations, so it failed to radically inspire the markets.

- Looking at the performance over the month of May, risky assets offered the best results, but their margin over bonds was not very impressive. Despite the positive economic surprises, emerging markets (both bonds and equities) underperformed, reversing part of the stronger performance seen earlier this year. On balance we have made no major chances to our portfolio, but have reduced our risk profile somewhat as a result of the spread compression in the high yield markets. We remain neutral on equities and have set up a (small) long position in the pound in anticipation of a Bremain outcome.

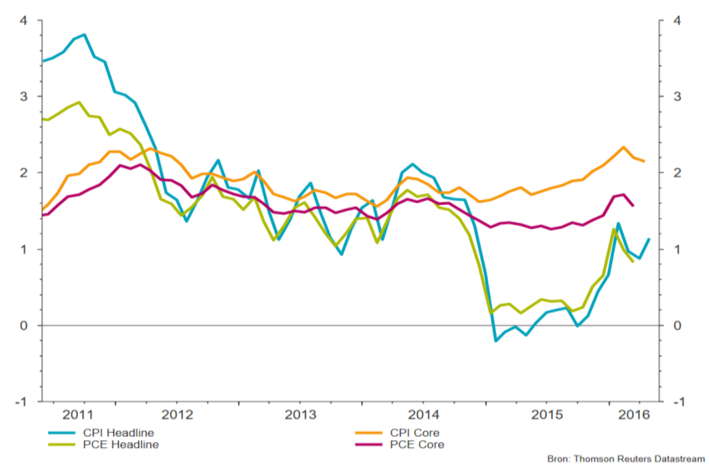
Economy

United States

Upward revision 2016Q1



PCE developments give the Fed some leeway



- The initially very weak GDP figures for the first quarter have been adjusted upwards to show still less than impressive growth of 0.8%. The key driver remains consumption. The puzzling fact remains that this year there are no meteorological factors to explain the increasingly apparently customary first-quarter weakness in the US economy. Will a stronger second quarter then only be a technical statistical blip? There is a risk that Q2 strength versus Q1 weakness will only be a statistical artifact, suggesting that the remaining quarters of 2016 may remain weak.

- Ongoing strength, however, in the labor market, retail sales and the housing market suggest that the US economy continues to strengthen. We still consider a growth rate of GDP of 2.0% for this year likely. Inflationary developments have been relatively benign in recent months. This reduces pressure on the Fed to act. Nevertheless, we consider an additional modest rate hike of 25 basis points to be likely in July, which will help the dollar. Additional tightening later in 2016 is unlikely in the light of upcoming elections in November and the fact that a December rate hike is unpalatable due to reduced financial market liquidity.

- One worry for the US economy is the lack of an investment upsurge. We do not expect an improvement in short term, as animal spirits remain dampened by ongoing external uncertainty and the risk of a Trump presidency.

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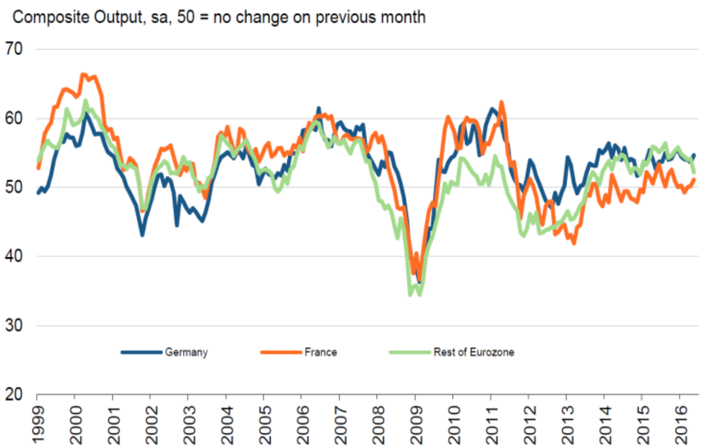
Europe

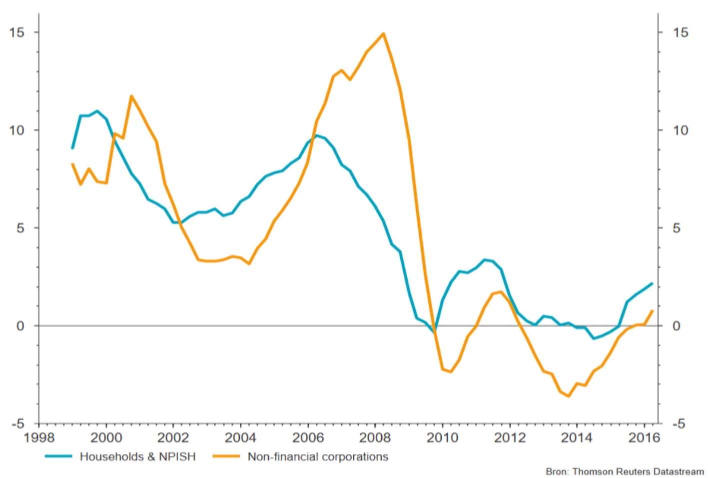
Economy

France(!) and Germany accelerating, the rest weakening



Source: Markit

Euro area lending on the rise



- The European economy continues to perform moderately well. France is surprising on the upside and Germany continues to show robust growth. Unfortunately, the rest of the Eurozone is weakening, but we, nevertheless, expect grow of 1.75% in 2016. Eurozone lending is on the rise, although the rate of growth is still low. The ECB will refrain from additional stimulatory measures, as upward pressure on the euro will probably be lessened due to the Fed rate hike, which is most likely to be in July.

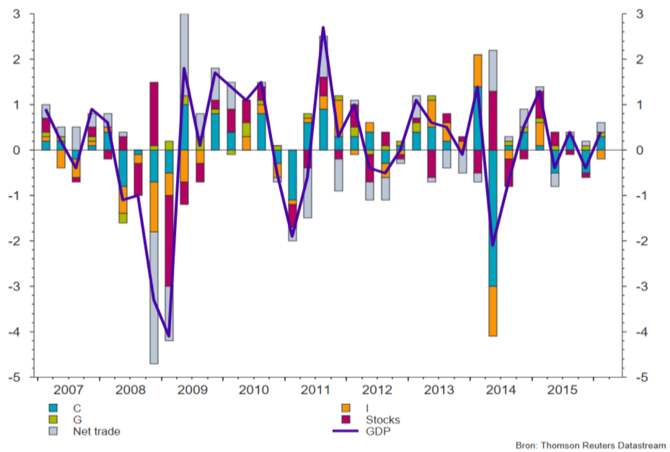
- Not surprisingly, the complicated three-dimensional chess game around Greece has ended in a compromise. Greece is indispensable in the current refugee crisis. The can has been kicked further down the road, at least until this autumn, but most likely still further into the future, until after the elections in autumn 2017.

- The June 23 Brexit referendum is looming. We expect the Bremain camp to win. The vote differential will be crucial, as only a significant majority will enable this issue to be buried for at least a generation. Shortly after the Brexit referendum in the UK, new Spanish elections will probably not result in much difference in the composition of the Spanish parliament. So far, political stalemate hasn’t damaged the Spanish economy, but in this second round there is much more pressure on politicians to establish a workable coalition.

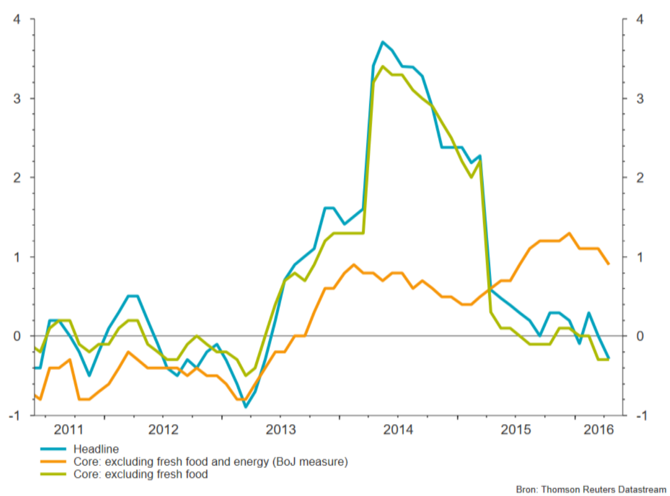
Economy

Japan

Japanese economy shows surprising strength in 2016Q1



Drifting into deflationary territory once again?



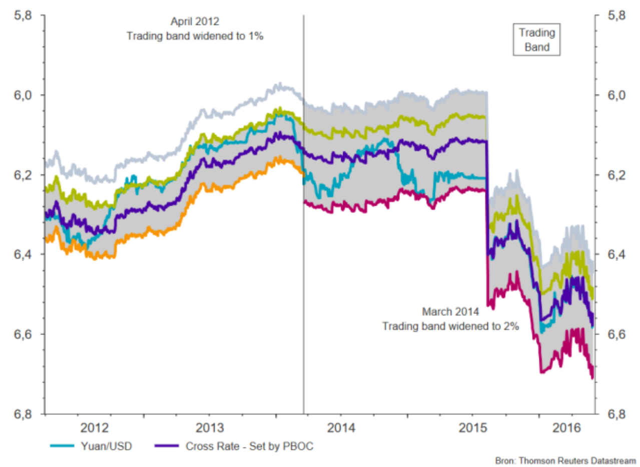
- As expected, but in contrast to his earlier remarks, Prime Minister Shinzo Abe has announced plans to postpone a VAT hike from 8% to 10%, scheduled for April 2017 by two and a half years, so effectively to October 2019. The Japanese government is preparing fiscal stimulus of around 1% of GDP. As a consequence, fiscal discipline is decaying once again. At this moment, it seems unlikely that Abe will risk a snap election for the Lower House, to coincide with the Upper House elections in July. It would be Abe's chance to cement his position of power for years to come, but due to the mixed success of his policies, he apparently doesn't want to take the risk.

- After three years of (over)reliance on monetary policy, the focus of Abenomics has shifted once again to fiscal policy. There is now less pressure on the Bank of Japan to provide further monetary stimulus. Still, we do not rule out some modest additional monetary action, most likely on July 29, when the Bank presents its next outlook, which includes growth and inflation forecasts. One argument to support such a move would be the decline in the BoJ's preferred inflation indicator.

- The GDP figures for the first quarter showed surprising strength, but we are not inclined to take these at face value. GDP figures in Japan are apt to undergo large revisions and recent indicators suggest the economy remains weak.

Our highlight this month: China

Chinese authorities allow yuan depreciation <commas ipv decimal points>



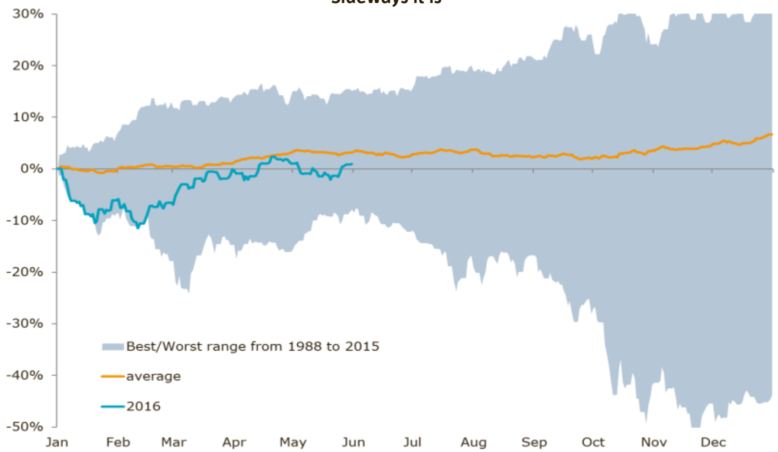
Weakening of the real broad effective exchange rate

– Recent strength in the US dollar has prompted the Chinese authorities to allow the yuan to weaken somewhat to protect China's competitive advantage. The modest depreciation of the yuan versus the US dollar was taken calmly by financial markets, which consider a drastic depreciation of the yuan unlikely. We subscribe to this view, as the economy is currently strengthening and the Chinese authorities most likely prefer to avoid heightened trade tensions with the US in the run-up to the November presidential elections. They probably won't try to help the rise of Republican frontrunner Donald Trump with an apparently hefty protectionist agenda. We expect Clinton to win by the way, but Chinese caution is understandable as a Trump win is a non-negligible risk. But the Chinese authorities will resist any dollar strength by allowing the yuan to depreciate modestly. The Chinese authorities are nominally allowing the yuan to shadow a currency basket, but their policy is more likely to be strictly discretionary. Nevertheless, a one-off depreciation is unlikely for the time being.

– PMI figures for April come in lower than the surprisingly strong March data. According to official and Caixin manufacturing indices, domestic and external demand is coming down and employment conditions have weakened. All in all the cyclical recovery in China is less than assured, though we expect the authorities to step up their stimulus measures if the economy weakens further.

Equities (I)

Sideways it is



source: Bloomberg, MSCI world

Looks like June is going to be a busy month...

Figure 1: Selected events in June

Date	Event
01 June	Closing day of the current session of the Japanese Diet
02 June	ECB meeting and press conference
10 June	ECB announces intended bank repayments of TLTRO I
15 June	FOMC meeting and press conference
16 June	BoJ meeting and press conference
21 June	German Federal Constitutional Court ruling on ECB OMT programme
24 June	Result of UK referendum on EU membership
26 June	Spanish general election
24 June	Results of first TLTRO II auction
30 June	Due date for a decision on the European FTT

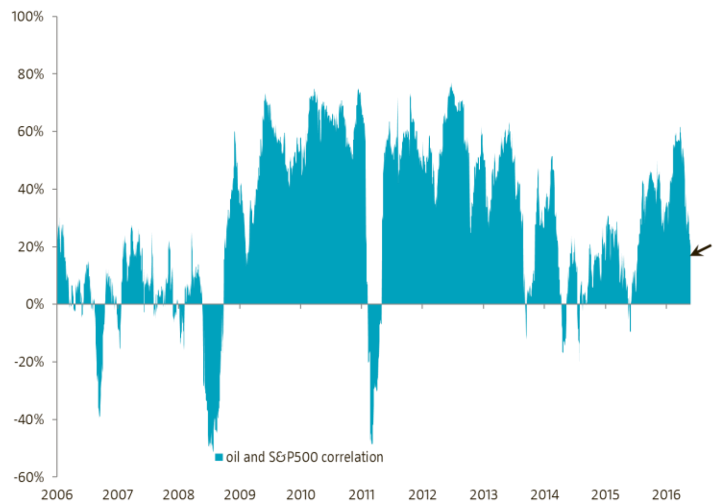
Source: UBS

- Following the roller coaster ride in the first four months of the year, global stocks seem to have adopted a wait-and-see mode in May. To rephrase this, stocks finished the month slightly higher, but on an intra-month basis the move were not extreme or in any particular direction: one day up, the next day down. On balance, the MSCI World is now virtually flat for the year to date, with losses in Europe and Asia being offset by gains in the US.

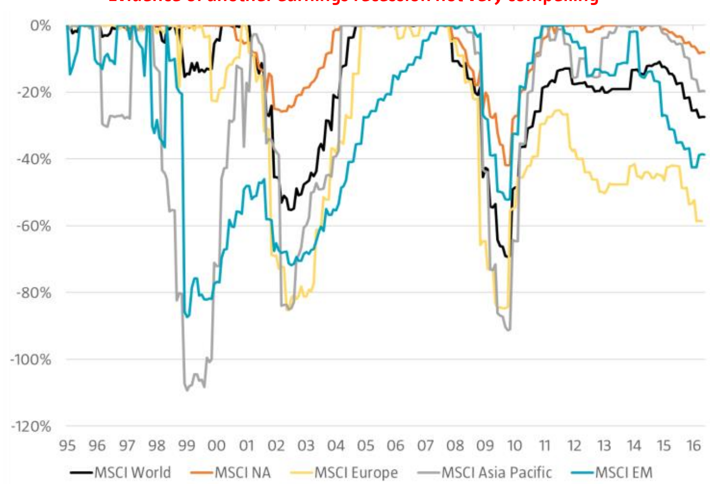
- Wait and see. This raises the question of what we are actually waiting for. Looking at the schedule for the month of June, there are a number of high profile events, including the Brexit vote, various central bank meetings and the outcome of the Spanish elections (see schedule on the left). Unexpected results for any of these events could certainly send the stock market off in a new direction, but in our experience the market seldom sticks to a calendar when deciding what its next move will be. In addition, the fact that we do not expect big surprises for these two events: the Fed will probably wait another month, while we expect the majority of the British voters to opt for the no-change option. The biggest uncertainty appears to be what will happen in Japan in the months to come, but this is linked more to the political/budgetary situation (VAT decision, new fiscal stimulus, possible new elections) rather than extra BoJ stimulus.

Equities (II)

As expected, correlation between oil and stocks has declined markedly



Evidence of another earnings recession not very compelling



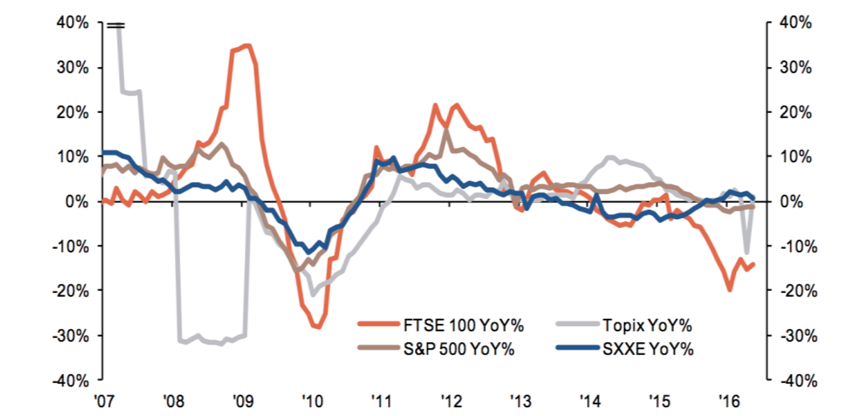
- So if it is not a preset agenda that will drive the market, what will? The answer to this question was pretty simple during the first couple of months of the year: oil. However, with oil back at USD 50, right in the middle of what we consider to be the neutral price range of USD 40 - 60, it is clear that the commodity has lost its ability to move the markets much these days. The 50-day correlation between oil and stocks had declined from a high of 62% in March to below 20% by the end of the month. The default spillover threat has been reduced, oil stocks have rebounded, while the need for liquidations by oil funds has also been reduced. Unless oil surrenders the gains it has made over the past two months, we do not expect the oil market to become the leading theme again.

- One of the main reasons why stock markets have been reluctant to move higher, has been the weakening trend seen in global corporate earnings. The chart on the left hand side shows the (trailing) EPS drawdown of the various regions for the MSCI Indices, compared to the highs reached up to that time. The chart clearly shows that earnings for the MSCI World as a whole have never managed to surpass the 2007 high, which has been mainly the result of the steady shortfall seen in Europe. The ominous sign here is the synchronized decline in earnings that has taken place since the middle of 2015: the last two times this happened over the past 20 years, it did not end well for stocks...

Equities (III)

It is not just reported earnings that have been weak...

Anaemic revenue growth (yoy)



12-month trailing sales in local currencies, growth year-on-year; Sources: Datastream, Worldscope, SG Cross Asset Research/Equity Strategy

Stocks in emerging markets and Europe have now become cheap

Cyclically adjusted price / earnings

Ratio

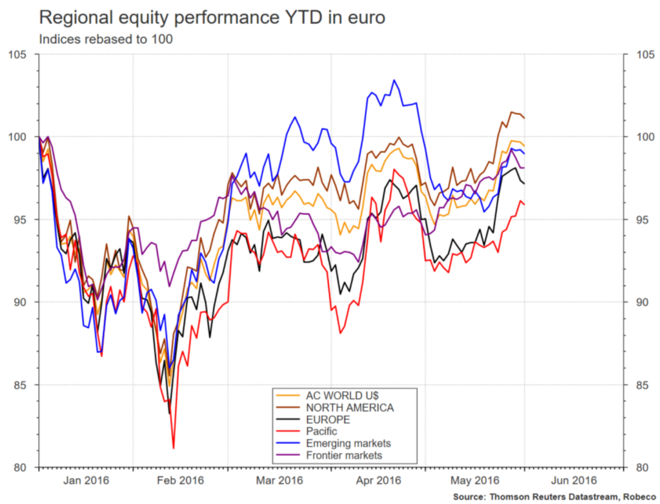
Bron: Thomson Reuters Datastream,Robeco

- This weakness is only partly linked to the weaker earnings in oil and commodities: global EPS growth excluding oil and financials reached just 1.8% in 2015, while first quarter 2016 data clearly indicate further weakening. Of course, the real stock market bulls will be eager to point out that these are trailing earnings and that markets are known for being forward looking. As oil prices rebound, an important drag on earnings will disappear, which could mark the end of the earnings decline seen so far. This is probably the sign that the market is waiting for.

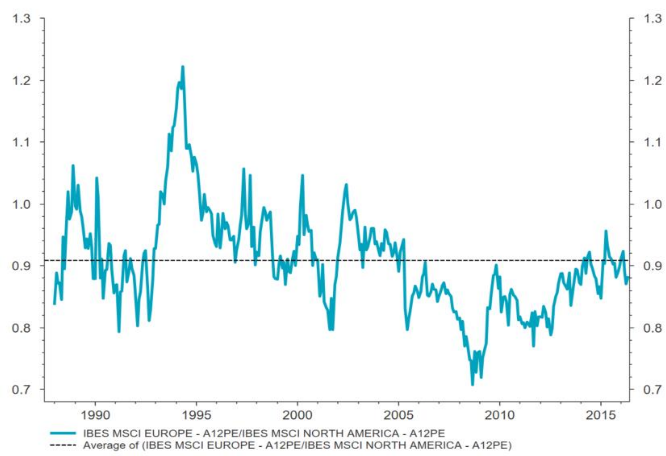
- Still, even if earnings rebound from here, we find it hard to believe that all the concerns that dragged the markets aggressively lower at the start of the year (weaker China, the loss of credibility of central banks, the strong rise in corporate debt) have suddenly disappeared. With the possible exception of China, these issues are of a more structural nature and could therefore return as a potential drag on the market moving forward. In this environment, the best trading strategy is to operate from a neutral tactical position. Although globally we continue to expect risky assets to deliver better returns than safe assets over a six to 12-month timeframe, we still think that high yield offers a better risk/return trade-off than equities right now.

Developed Market Equities

Momentum improves



European equity valuations getting more attractive

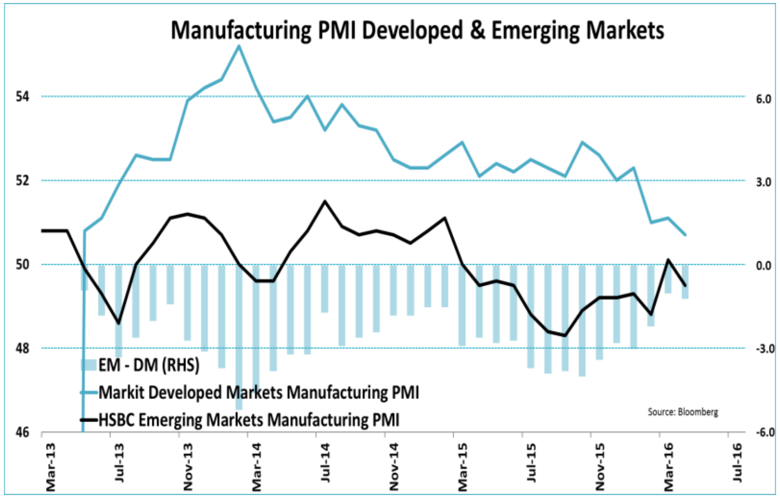


- Developed market equities ended the month marginally higher, leading to an underlying improvement of the overall technical picture. Momentum on a one-month basis in euros has remained positive with European equities starting to catch up, but with the US still leading as the dollar strengthened against the euro. The Pacific region is struggling with weak momentum in euro terms despite the stronger yen, as anemic export growth and a lack of additional monetary support cause headwinds for Japanese stocks. Longer-term momentum still strongly favors the US. The leading position of US equities could run into a situation of diminishing returns as the margin pressures in the US rise versus other developed markets as a result of its tight labor market.

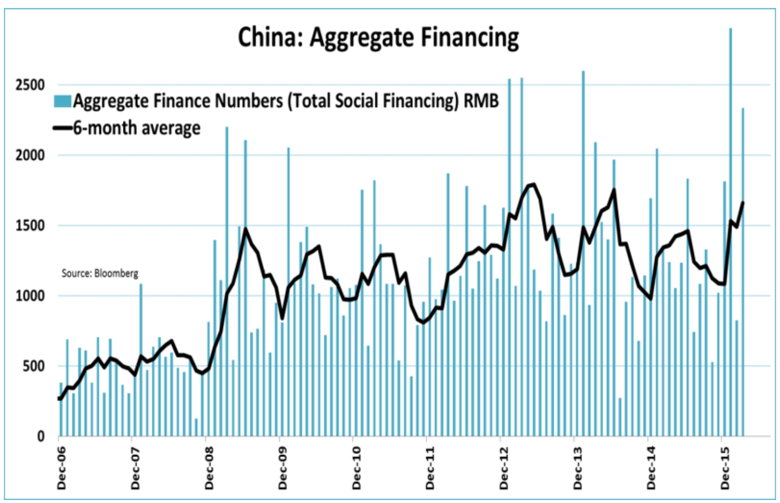
- Valuations based on CAPE indicate global equities have become more expensive. Looking at forward P/E ratios, European equities have become cheaper relative to the US, and are once again trading below the historical forward discount against the US. The upgrading of 12-month forward earnings growth in Europe has contributed to this as the European economy is showing better growth prospects with the IFO expectations at 101.6 showing upbeat business morale. Looking ahead, the Fed will likely hike this summer putting pressure on elevated US valuations. We prefer European equities to their US counterparts.

Equities: Emerging vs Developed (I)

EM v DM PMI



China credit growth



- Emerging markets lagged developed markets in May. The return of Fed rate hike speculations and the strength of the US dollar that came with it, were the most dominant factors impacting emerging market equities.

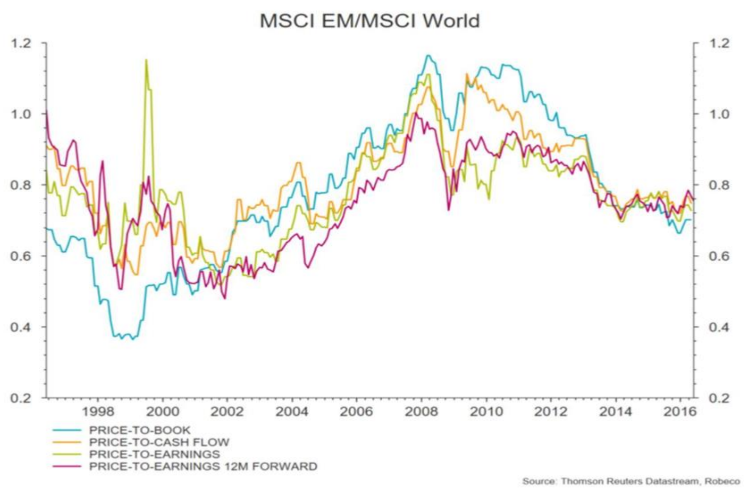
- The outlook for emerging economies remains muted. The Manufacturing PMI failed to rise above 50 again, indicating slower GDP growth going forward. And while the gap between EM and DM PMIs decreased, the reason for this was not so positive. The DM manufacturing PMI has come down faster than that of EM.

- Within the EM universe most attention, obviously, goes to China. By now it is common knowledge that China has a corporate debt issue. Credit growth remains strong adding to these concerns. The infamous wealth-management products, vehicles increasingly used by banks and local governments to attract funds, are under severe scrutiny, as the returns they have to pay out are ‘ambitious’. Also, estimates of non-performing bank loans range from anywhere between 5% to 20% (1.6% is the latest official number). We should take into consideration, however, that the Chinese government can mop up a lot of these bad debts, if it wants to. In recent months we have seen some defaults, but for now it seems as if China is trying to

Equities: Emerging vs Developed (II)

EM and the dollar

Valuation discount



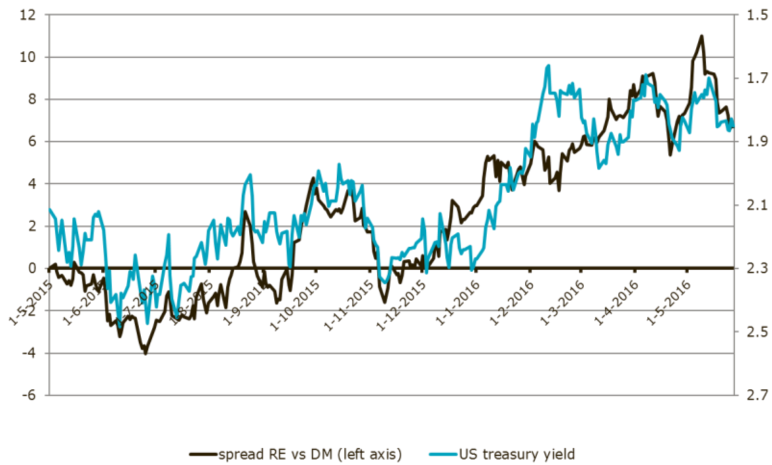
- kick the can down the road. Meanwhile, the 'targeted stimulus' seems to be over for now and so economic momentum has waned somewhat. Although, as is the case every year, numbers are distorted by the Chinese New Year.

- As we have already mentioned, we would like to see a weakening of the US dollar, higher commodity prices and improving fundamentals to upgrade emerging markets. While there is some, albeit not much, evidence for the latter, earnings growth could improve as a result of currency depreciation, the US dollar is actually rising again. Investors seem complacent about the next Fed rate hike which could come as early as June. This could push the US dollar higher.

- We do not expect commodity prices to continue to rise at the pace seen in recent months. Markets are clearly anticipated that the imbalance between supply and demand will dwindle going forward. We would have to see an acceleration of growth for commodity prices to move significantly. In addition, fundamentals have improved somewhat, revenue and profit growth have yet to pick up. Also the fragile situation of countries like Brazil, the latest PMI came in at 41.6, and South Africa, poses a risk. Yes, valuation remains attractive, but for a reason. We remain marginally underweight emerging markets.

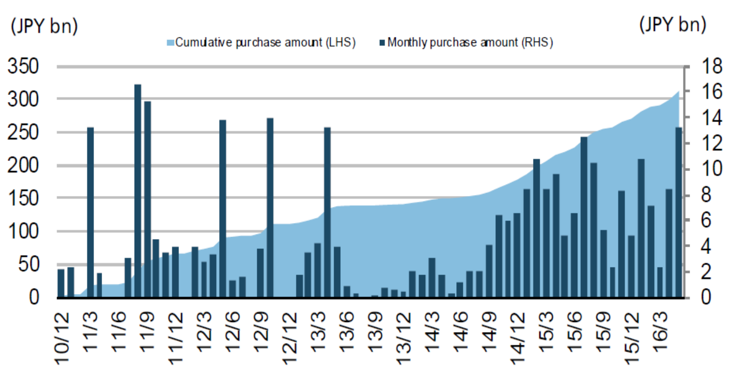
Real estate

Outperformance of real estate



BoJ still buying J-REITs on a large scale

Figure 24: BOJ owns ¥312.3bn of JREITs as of 27 May



Source: BOJ, UBS

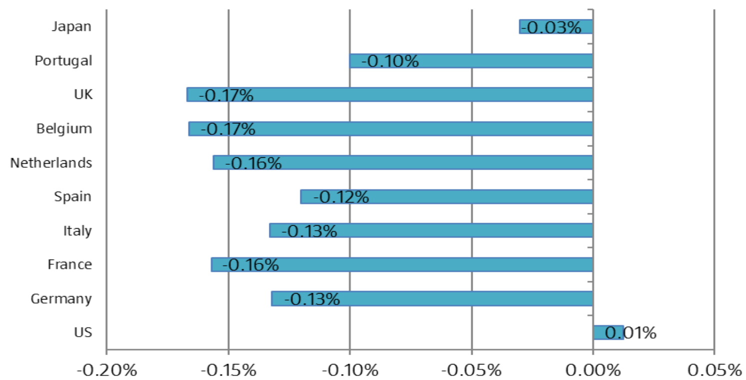
- Real estate performance was mixed last month compared to movements in global equities. The possible Fed rate hike, which is expected either this month or in July, had a major influence on the interest rate movements worldwide. As the correlation between US bond yields and the relative performance of real estate versus developed market equities made a comeback, real estate declined as Treasury yields rose in the second half of May. At the end of the month, the S&P Developed Property Index (in USD) closed more or less flat (+0.1%).

- In May, the BoJ bought the highest amount of J-REITs on a monthly basis since 2013. However, the majority of investors were on the sell side to take profits, something which is expected to continue for a while. J-REITs are still expensive with a premium over the NAV of around 30%. However, a dividend spread of 3.4% makes J-REITs attractive compared to Japanese government bonds.

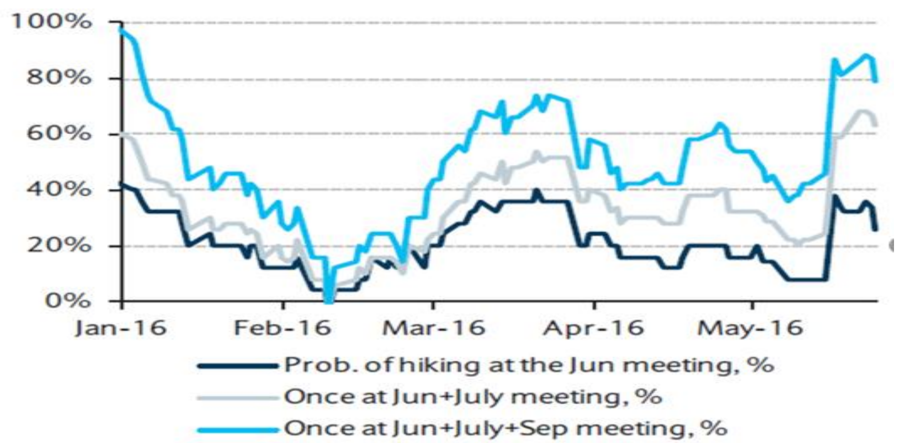
- Continental European real estate benefits from the ECB's low interest rate policy, while some parts of the UK market are heavily overheated. Overall, we remain neutral on worldwide real estate.

AAA Bonds (I)

European markets felt pressure of ECB purchases while US market started to price in more hawkish Fed



Reprising rate hikes



Source: Bloomberg, Barclays Research

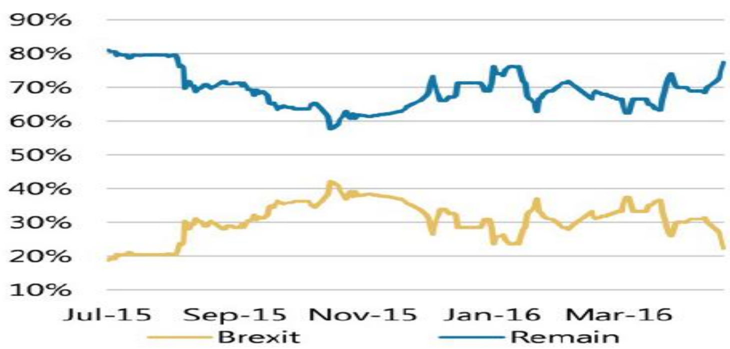
Source Bloomberg, Citi

- Last month's bond markets saw some quite distinctive moves last month as we saw the yields of most Eurozone countries decrease firmly, while in the US yields remained steady. This nicely reflects the policy divergence that started to reemerge during the month of May. The trigger for this was the release of the minutes from the Fed's April meeting. Its more hawkish tone caught the market slightly off guard, as it was in the process of almost completely pricing out any rate hikes for 2016. Apparently, the reversal that followed the release of the minutes was just what the Fed wanted, as they had plenty of opportunity to push back but refrained from doing so.

- What is striking though is that this apparent change in the Fed's tone occurred at a time when one of the few economic numbers to hold its ground in a weak first quarter showed signs of weakness: the latest payroll figures were disappointing. We (and the market) will keep a close eye and try to assess whether this is a temporary issue, or a more structural event. If the Fed continues to be dismissive about a slowing job market, this will be a good indication that its response function has changed markedly. This implies that threshold where economic data could trigger a hike is lower than we and the market initially thought.

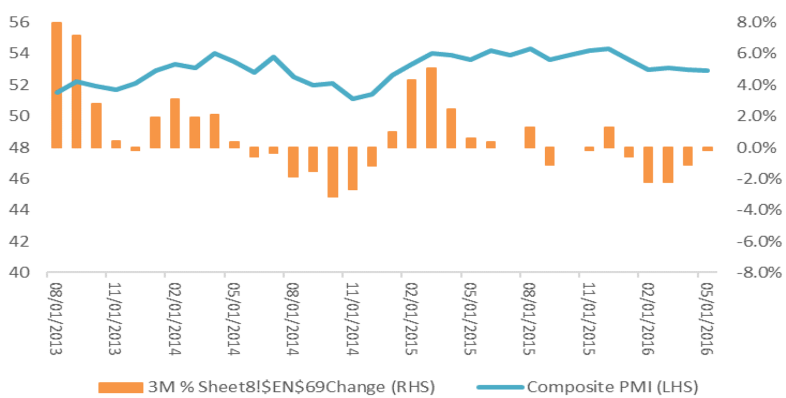
AAA Bonds(II)

Betfair probability of Brexit : Bremain gaining ground



Source: Morgan Stanley Research, Betfair

European economy chugging along nicely



Source Bloomberg

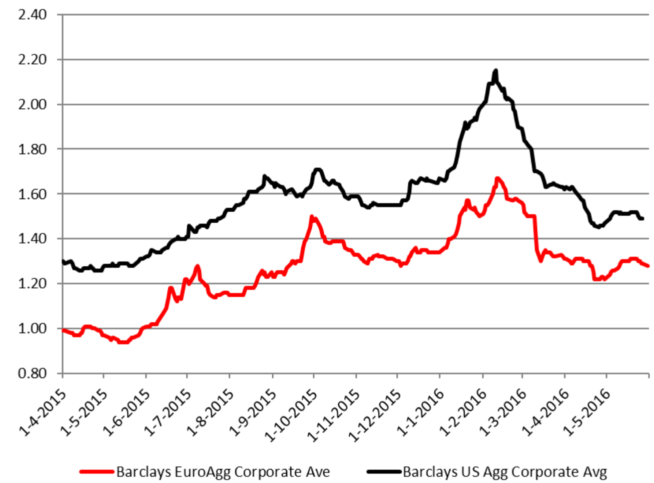
- We continue to expect no change in policy in the near term from the ECB. The Eurozone economy is chugging along nicely and most of the previously announced policy actions (LTRO and purchasing of corporates bonds) still need to be implemented. The ECB will take time to assess the effectiveness of these measures.

- Whether the ECB will indeed be allowed to wait and see will be determined by political developments. While there is ample evidence of global electoral dissatisfaction, in June we might get a first real taste of this as we head for the Brexit vote. Fortunately the 'Bremain' camp has been gaining ground lately (looking at the bookies, at least), so let's hope this doesn't become more than just another worry. In Europe we also need to remain aware of the technical implementation of ECB bond buying. This can lead to unexpected moves in the market, as we have seen over the past 12 months. In April the increase in ECB purchases were met by an increase in supply.

- We continue to think that bonds offer no value, but currently we also see no immediate trigger that will push rates higher, we therefore prefer to remain on the sidelines for the coming period.

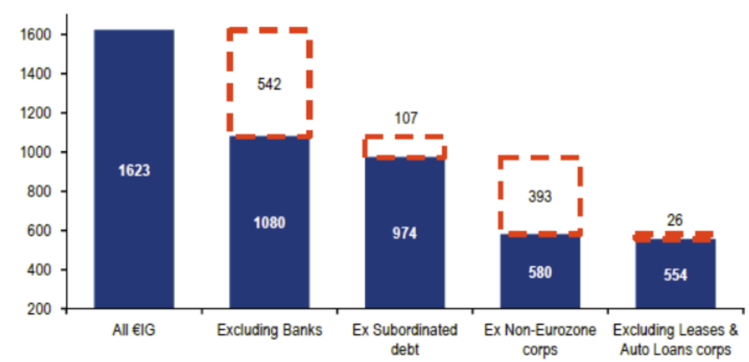
Investment Grade Credits

European and US spreads trading in a close range



The eligible set for CSPP

Chart 3: The Euro IG credit universe is €1.6tr. But when exclusions are made, the universe shrinks to €554bn



Source: BofA Merrill Lynch Global Research. Chart shows remaining IG credit universe when certain sectors are excluded. Note sub debt will include corporate hybrids.

- Credit spreads in Europe and the US were in a close trading range during the month of May. In Europe, spreads traded in a range between 1.24 and 1.31, closing the month at 1.28. In the US the range was even smaller: 1.46 -1.52, and they ended at 1.49.

- This was perhaps a bit of calm before the storm. June is going to be an important month for European credits. Two major events near the end of the month will set the direction. First, on 23 June, Great Britain will vote on whether they want to stay in Europe or not. Our stance is that the British people will not vote for an exit. But if that proves to be wrong, credit spreads will certainly show some volatility during the summer. A couple of days later, the ECB will start with its CSPP program. Consensus in the market is that the amount will be around EUR 5 billion per month and a significant deviation from that amount could cause volatility. The risk is on the downside where a disappointing amount will cause a spread widening.

- The eligible investment universe is tilted towards lower yields. Around 15% of the universe already has negative yields and less than 20% has yields of more than 1%. Yield compression has also been accompanied by flatter curves. Investors have to look at

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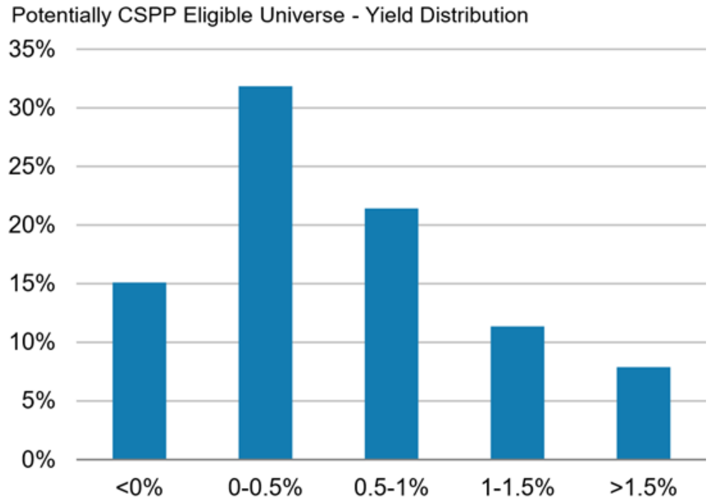
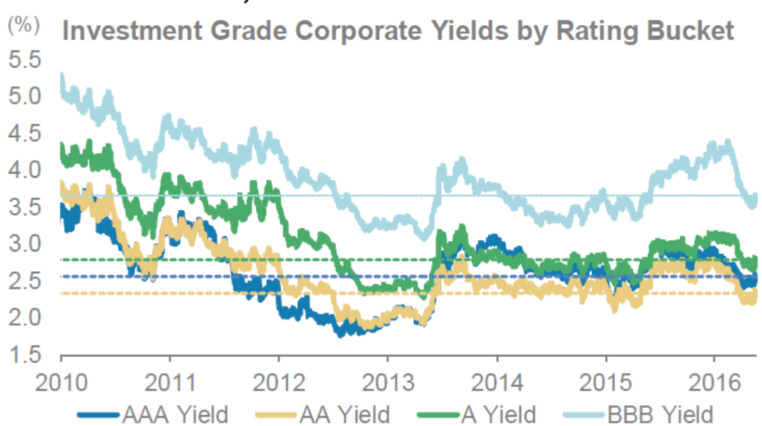
Investment Grade Credits

Yields of bonds eligible for the ECB are already relatively low



US credit yields attractive across different buckets



Source: Morgan Stanley, Citigroup Index LLC

- bonds with a maturity of longer than 7 years to get a yield above 1%, whereas these yields could be found in the 1-3 year bucket at the beginning of the year. There are higher yields available in the set of issues that are not eligible for the CSPP program: the financial credits. We expect yield seeking investors to eventually turn to these bonds.

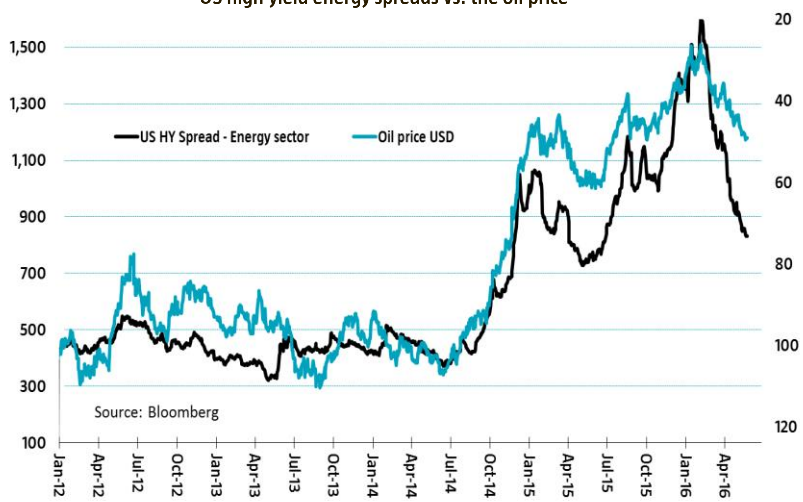
- In the US, yields look more appealing than in Europe, where even the 1-3 year AAA-bucket yields well above 1%. A possible Fed rate hike is not expected to affect spreads that much. So, from a yield perspective, US credits have become increasingly attractive, even if the spread movement will not be as favorable as in Europe. There is of course currency risk when investing in US credits, which can put a drag on the eventual returns. As we expect the US dollar to eventually strengthen against the euro with some volatility, this shouldn't be a negative factor for the time being. Leverage-levels are an issue, though.

- We have an overweight position in European credits as the ECB will be in the market as the 'ultimate buyer'. We expect spreads to tighten further, paving the way for financials to profit from the search for yield later on. We expect spreads in Europe tighten and therefore we prefer European credits over US credits, although yields in the US are favorable, but contains some currency risks.

High Yield (I)

Global high yield spreads have fallen

US high yield energy spreads vs. the oil price



- After a couple of very strong months for high yield bonds, the asset class took a breather in May. Spreads tightened marginally helping high yield realize a small positive return during the last months. Still, the massive tightening since mid-February, equaling roughly 230 basis points, remains impressive.

- The further tightening of the average high yield spread in May should be attributable to US high yield energy bonds. As oil prices rose more than 10%, energy-related spreads tightened significantly in May. The relatively large move in energy spreads compared to the move in oil prices (see the second chart on the left) can be explained by the fact that that investors lost track of reality back in February. At one point the implied default rate of energy-related high yield companies topped 50%.

- That said, the massive move in energy high yield spreads implies that investors' views on future defaults have normalized somewhat. From this perspective, high yield bonds have lost some of their relative value. In addition, we think it's unlikely that oil prices can continue to rise at the pace we have seen in the last couple of months. As OPEC and Russia have demonstrated, at this point, no oil-producing country is really willing to shed production to push up prices.

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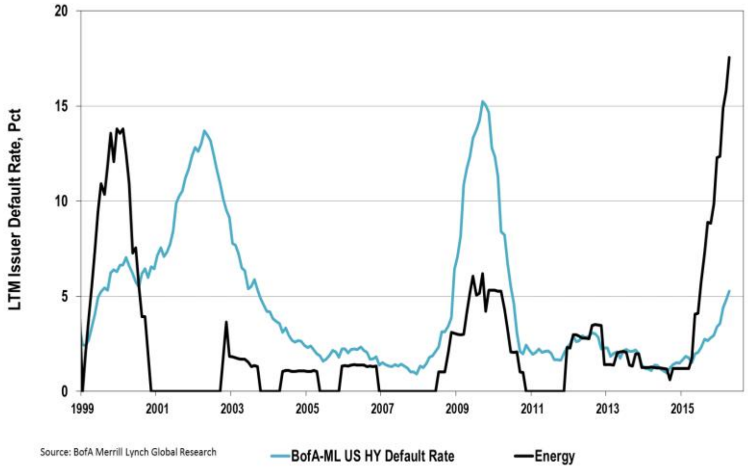
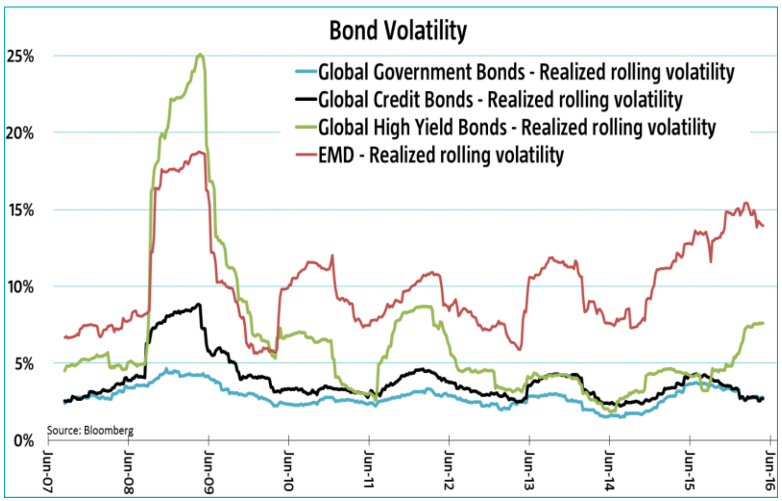
High Yield (II)

Defaults



Relative valuation



- High yield bond defaults are concentrated in the US, where commodity companies, and energy companies in particular, are under severe pressure, even though oil prices recovered. An important aspect of the energy-related default cycle, defaults have risen to over 17%, is the fact that banks are less willing to lend to commodity companies.

- Outside the US, however, things look more upbeat. Defaults are still pretty rare, below 1% in Europe for example, but are expected to rise, which is reflected in the average spread which is way above the lows earlier on in this cycle. We expect things to stay this way. Recession aside, we think high yield offers decent value at this point in time. A Chinese default cycle and/or a renewed downturn in commodity prices are the most important risks for our scenario.

- The valuation of high yield bonds remains attractive, albeit much less so than a couple of months ago. High yield offers more value per unit of risk than emerging market debt and government bonds, which remain expensive, especially in Europe. However, as the graph to the left reveals, risk has increased for high yield and we expect this to remain so going forward. Hence our reduced overweight in high yield, with a preference for European HY bonds.

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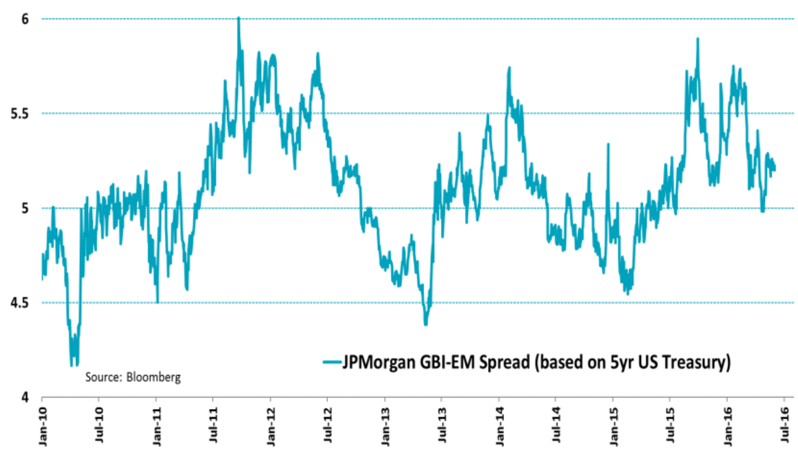
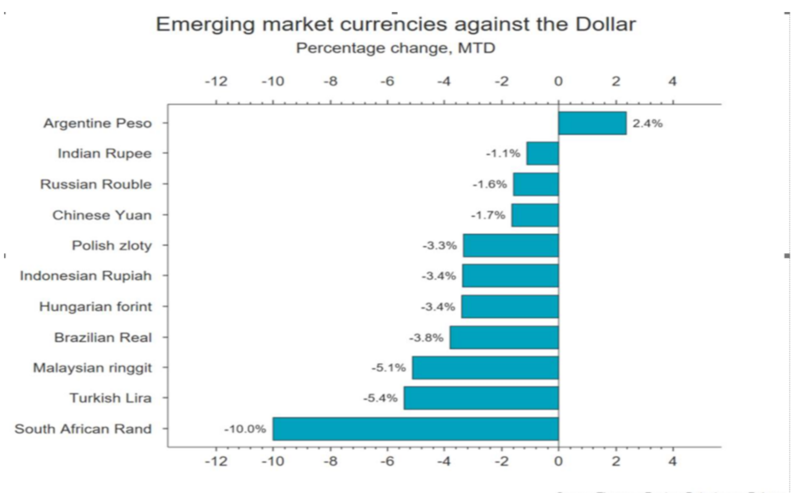
Emerging Market Debt (I)

Emerging Market Debt spread based on the 5-year US Treasury yield



EM currencies against the US dollar



- May was a poor month for emerging market debt. Spreads widened only marginally, but emerging currencies depreciated significantly. In May, there was a significant reversal from March and April, which underpins the riskiness of this asset class.
- As the bottom-left graph shows, emerging currencies depreciated quite significantly against the US dollar in May. On average, currencies weakened 4%, giving away some of the gains booked since January. The US dollar strengthened across the board as the Fed implied that another rate hike would be appropriate in the coming months.
- The top chart on the next slide shows that a strengthening US dollar is accompanied by emerging market debt underperforming developed market government bonds. With the Fed ready to hike, and the market being somewhat complacent about it, we imagine the US dollar could strengthen further.
- Differences within the emerging debt universe remain large. Brazil stands out as one of the weakest countries. Politically things look pretty ‘complex’ and GDP growth is expected to shrink by approximately 4% this year. Structural reforms

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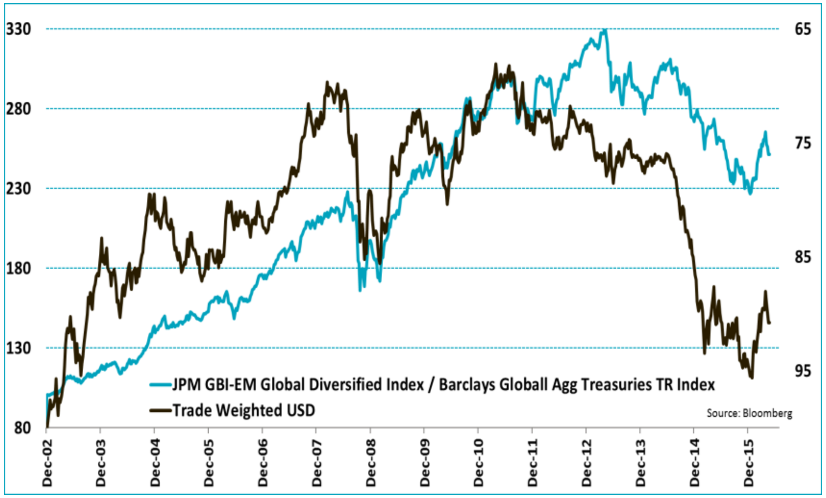
Emerging Market Debt (II)

South Africa – yield to maturity



Yield EMD vs High Yield

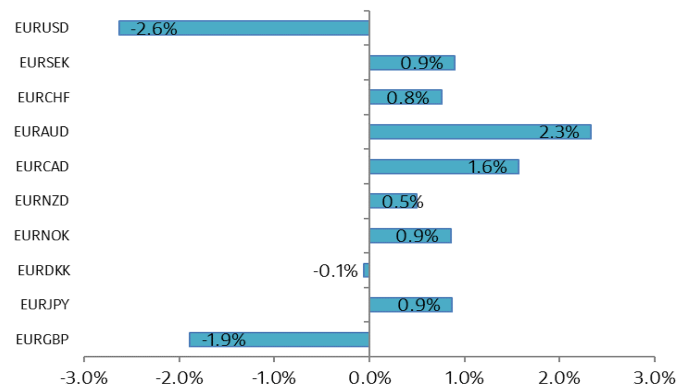
- have yet to be crafted and fiscal discipline is waning. In the light of these developments, Fitch also downgraded Brazil to 'junk' in May (the other two major rating agencies already did this in February). On top of that, inflation unexpectedly rose to above 11% again, which increases the odds that Brazil's central bank will have to raise rates again.

- For South Africa things are not great either. Inflation is above the central bank's target and growth is slowing. South Africa is also on the list for a downgrade to 'junk'. The positive side of this however, is that yields seem to reflect South Africa's fragile situation and the rand looks quite cheap. For Russia things look more upbeat, assuming that commodity prices don't collapse again. GDP growth in Q1 and the latest PMI figure were much better than expected, inflationary pressures are waning which means the central bank could lower rates. Russian bonds seem to offer some decent value. Mexico is on the other side of the spectrum showing resilience in the economy and a relatively strong currency.

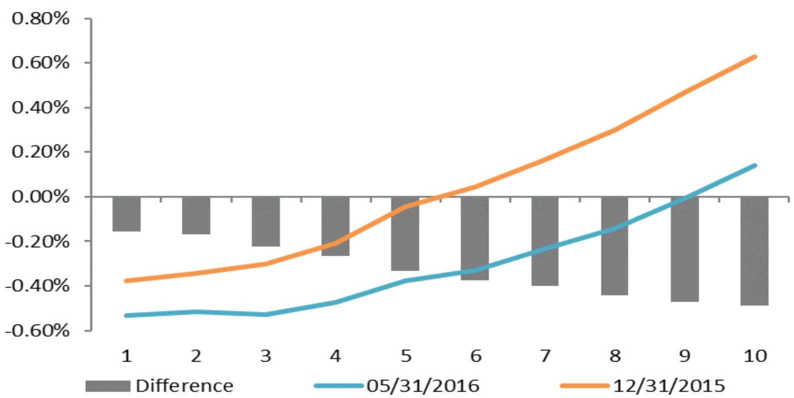
- We remain neutral on emerging debt. Yes the yield is great, but so is the risk. The divergence within the group is especially large at this point in time. A Fed hike is likely to be accompanied by pressure on emerging market debt performance.

FX (I)

USD strength returned in May



German rates continue to be pushed lower and offer appalling yield

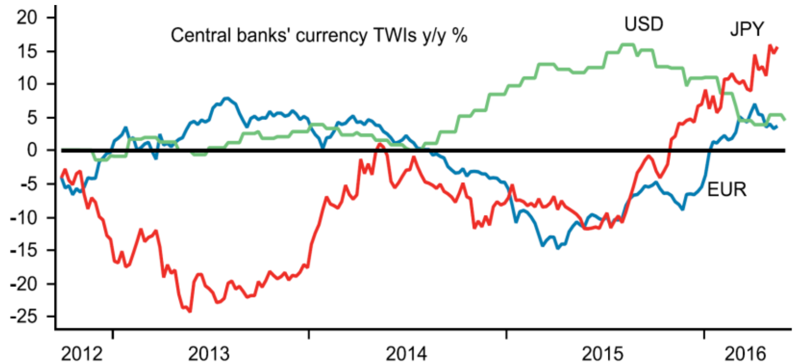


- In May it was all about the USD. The surprising U-turn of the Fed forced the market to rethink the timing and extent of any future rate hikes. Given the easing financial conditions, recovery of the stock markets and the improvement in economic data we have witnessed over the past period, one can sympathize with the apparent change of sentiment at the Fed. While Fed members seem to have subsequently more or less confirmed the more hawkish stance, we still haven't heard Yellen speak out on the subject and until she does we think the jury is still out.

- Given the repricing of rate expectations, it was to be expected that the USD would enjoy a strong month. Less obvious was the euro's pretty good performance within the G-10 currency bucket. This good performance was indiscriminate as the euro strengthened against both safe haven currencies (JPY and CHF) and against the so-called commodity currencies (AUD, NOK and NZD). The trigger for this definitely didn't come from the ECB, which is widely expected to have adopted a 'watch and assess' mode for the coming period. Also, given the fact that we haven't witnessed a massive upgrade of the European growth outlook and that European rates have continued to become less and less appealing from a yield perspective, we might just be witnessing strength by default.

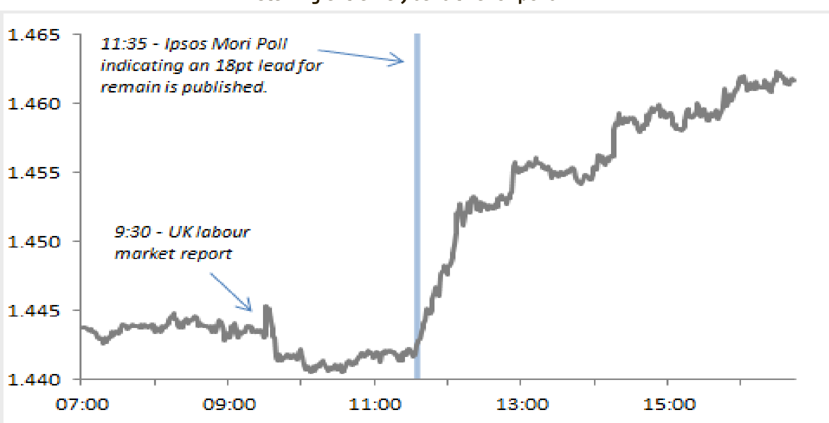
FX (II)

Yen continues to strengthen on a trade-weighted basis



Source: BNP

Sterling extremely sensitive for polls



Source: Bloomberg, Goldman Sachs Ipsos Mori

- The trade-weighted yen remains strong as the market continues to doubt the BoJ's commitment to more quantitative easing. Ultimately we think the BoJ will have to do something and this will most probably be accompanied by fiscal stimulus.

- Besides the USD, one other currency stood out this month and that was sterling. After weeks of continued downward pressure as a consequence of the uncertainty caused by the upcoming Brexit vote, sterling staged a remarkable comeback. This probably reflects the shift in the opinion polls/ betting odds that seemed to have now turned in favor of a 'Bremain'. We continue to think that ultimately the British will vote for certainty rather than taking a leap of fate into the great unknown. We therefore think that sterling will strengthen further. The shift in odds offered us an opportunity to go long sterling against the euro at a relatively good level. However, given the uncertainty that remains we are only willing to commit a small part of our risk budget to this position.

- We unfortunately missed the opportunity to enter into a long USD position at a good level. We currently therefore remain on the sidelines but we continue to look for an attractive level to enter a long dollar position.

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