ROBECO
The Investment Engineers

Multi-asset market outlook

Shifting into neutral

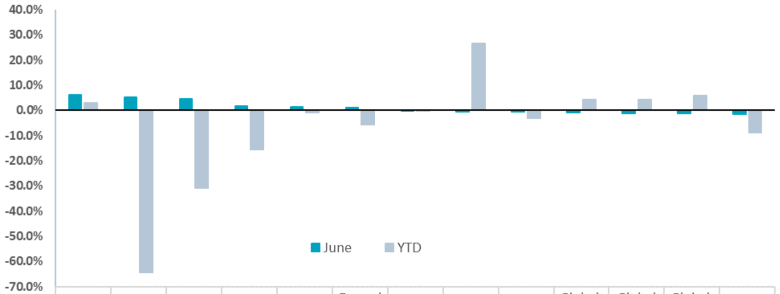
September 2020

For professional investors

Sustainable Investing Expertise by ROBECOSAM

General overview (I)

June: cyclical assets were the best performers



	MSCI World (H EUR)	Oil Index	GSCI Commodities	Global real estate	Global high yield	Emerging Markets (EUR)	Cash	Gold	EMD HC (UH EUR)	Global Inv grade bonds	Global Gov Bonds (H EUR)	Global Infl linked bonds	EMD LC (UH EUR)
June	6.2%	5.2%	4.6%	1.8%	1.3%	1.1%	0.0%	-0.4%	-0.4%	-0.8%	-1.1%	-1.2%	-1.3%
YTD	3.0%	-64.2%	-30.9%	-15.3%	-0.8%	-5.7%	-0.3%	26.7%	-2.9%	4.3%	4.4%	6.0%	-8.7%

Source: Bloomberg, Robeco

Positions: taking some chips of the table

	Portfolio	Benchmark	Active
Equities Developed Markets	24.00%	25.00%	-1.0%
Equities Emerging Markets	5.00%	5.00%	0.0%
Real Estate Equities	5.00%	5.00%	0.0%
Commodities	6.50%	5.00%	1.5%
Global treasuries	27.50%	27.50%	0.0%
German Treasuries	-1.50%	0.00%	-1.5%
US Treasuries	-1.50%	0.00%	-1.5%
Investment Grade Corp Bonds	20.00%	20.00%	0.0%
European Corporates	1.00%	0.00%	1.0%
US Corporates	1.00%	0.00%	1.0%
High Yield Corp Bonds	6.50%	5.00%	1.5%
Emerging Market Bonds LC	4.00%	5.00%	-1.0%
Cash	1.25%	2.50%	0.0%
EUR/USD	1.25%	0.00%	1.25%

Source: Robeco

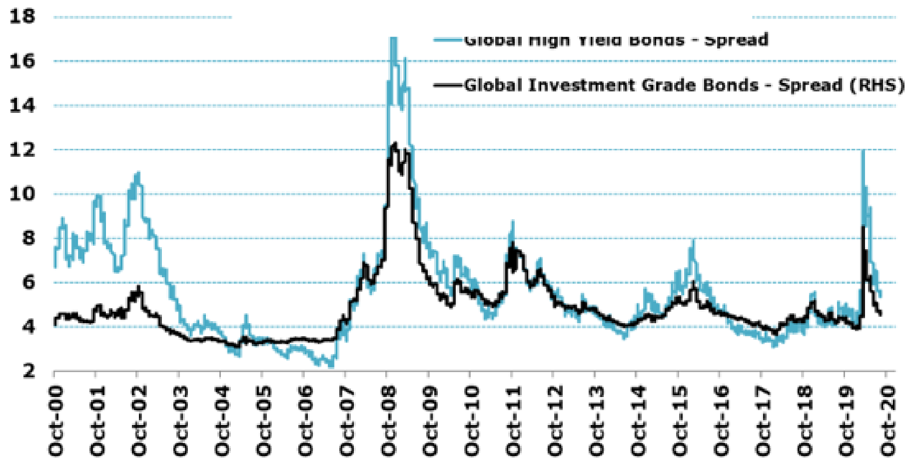
> In August, the risk rally continued. Equities, high yield and commodities all delivered decent returns. US equity markets led the way, with both the S&P 500 and the Nasdaq making new highs this month. The driver of US equity markets remains the tech sector. Risky assets continue to benefit from the supportive macroeconomic backdrop. Covid-19 remains a threat, but the chances of complete lockdowns are low because cautionary measures such as wearing face masks are helping to contain new outbreaks. With animal spirits returning, not much attention is currently being given to risks such as the US election, tensions between China and the US, and the uncertainty over a new fiscal package in the US. The changes made by the Fed to its monetary framework is a clear message to the markets that monetary support will be with us for quite a while. The same message has been given by other central banks.

> After moving overweight to corporate bonds in March and subsequently increasing our exposure several times this month, we started to trim our holdings. We lowered our exposure to both high yield and investment grade credit. For investment grade credit, we think the current spread is insufficient to compensate for the duration risk that comes with this asset class. Against the remaining position in investment grade bonds, we therefore hold a short in government bonds. Asset classes higher on the risk curve are better suited to perform well in the current environment. We therefore continue to hold on to high yield and commodities and remain close to neutral in equities. After the impressive rally of the EUR/USD, we lowered our exposure to euros.

Theme of the month

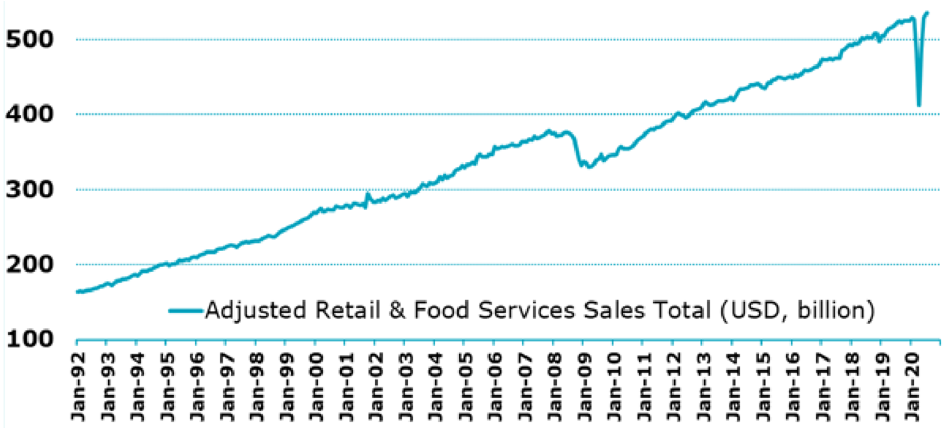
Shifting into neutral (I)

High yield and investment grade spread levels



Source: Bloomberg , Robeco

US retail sales rebounded strongly



Source: Bloomberg , Robeco

- After having been aggressively overweight in both high yield and investment grade bonds since the height of the Covid-19 crisis, we are now shifting towards neutral. Both asset classes have become relatively less attractive compared to equities, as spread levels have tightened significantly, and the global economy continues to stage a partial V-shaped recovery. We wait for new catalysts, either providing more upside or hurting sentiment, to reposition our multi-asset portfolios.

- We turned positive on global high yield and investment grade bonds in late March, when high yield bond spreads had risen to almost 1,200 basis points, pricing in a default rate of more than 20%. However, preventing company defaults and job losses became a key aspect of the close collaboration between central banks and governments. In addition, both the ECB and the Federal Reserve expanded their bond-buying universe, benefiting investment grade bonds as well as riskier high yield bonds.

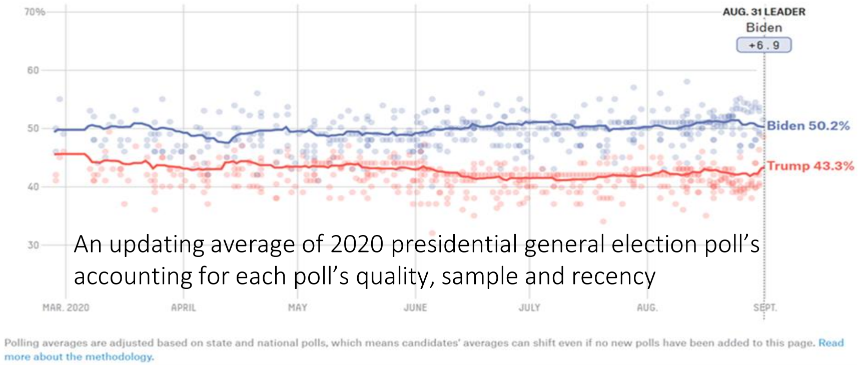
- Five months later, things look radically different. The strong cooperation between central banks and governments has become mainstream, pushing bond spreads to levels not that far from those seen before the global Covid-19 outbreak. This is at a time in which economic uncertainty remains exceptionally large. Bond yields, already low before the recession hit, have become even more suppressed, leading to a noticeable rise in bond duration.

- Relative to the diminishing attractiveness of investment grade and to a lesser extent high yield bonds, the alure of equities has increased. To be clear, on a standalone basis, equities do not look cheap, and in the case of the US they are outrightly expensive. But within a multi-asset portfolio, it's relative valuation that counts.

Theme of the month

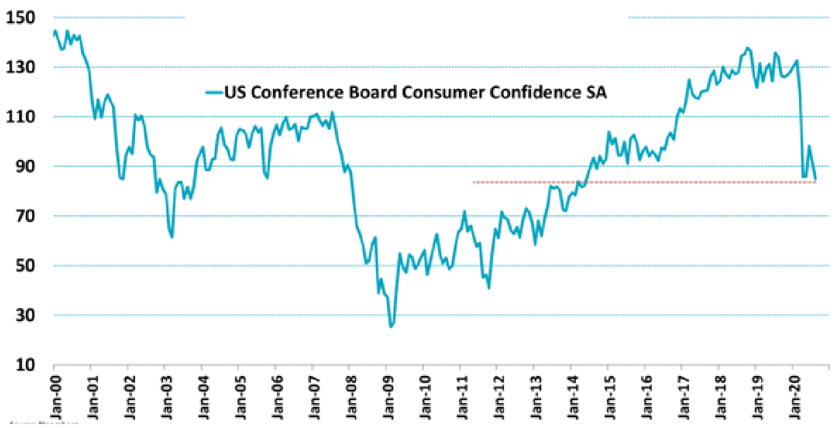
Who is ahead in the national polls?

An updating average of 2020 presidential general election poll's accounting for each poll's quality, sample and recency



Source: FiveThirtyEight

Consumer confidence is deteriorating



Source: Bloomberg, Robeco

Shifting into neutral (II)

> Recent economic developments also fit equities well. While we continue to believe that a V-shaped recovery of the overall economy will be difficult to achieve, developments in some areas do fit the definition. Retail sales, for example, are already above the levels reached before the global virus outbreak in many countries, including the US.

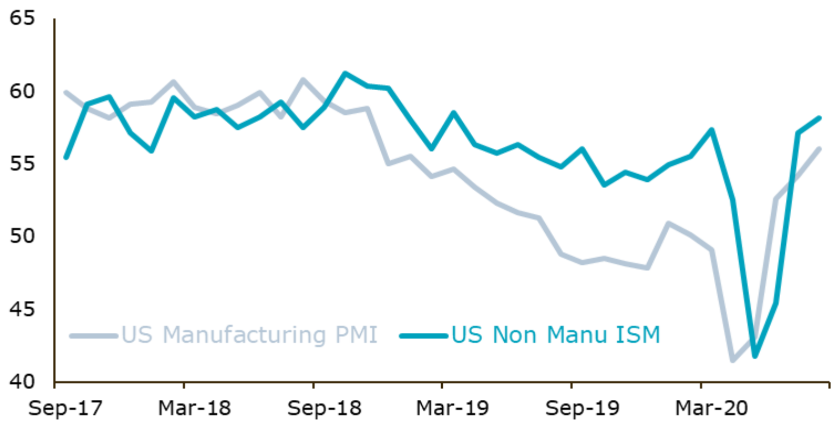
> The outlook for company earnings also looks a bit brighter. First, second-quarter earnings data was much better than expected, with US companies beating expectations by the largest margin on record. Second, we should not underestimate the impact of operational leverage. The flipside of the slower labor market recovery is that companies focus on productivity growth and lower costs.

> But caution remains warranted. The US elections are among the potential catalysts to derail the equity market rally. As economic circumstances continue to improve, and Covid-19 cases drop, President Trump's odds of winning a second term are likely to rebound. This would fuel discussions on fiscal stimulus and debt sustainability, which are less likely to occur in the event of a Biden win.

> A clear setback in the time-to-market of a Covid-19 vaccine would hit sentiment. Markets are pricing in the announcement of a 'vaccine gamechanger' anywhere between now and the end of the year. While there are currently eight vaccines in large-scale efficacy tests, no cure has yet emerged. The absent recovery in consumer confidence also remains a risk. Impacted by massive lay-offs, US consumer confidence has dropped to a six-year low. In Europe, consumer confidence remains significantly below the levels seen before Covid-19. Finally, seasonality is a negative. Equities tend to struggle somewhat on average during this period of the year.

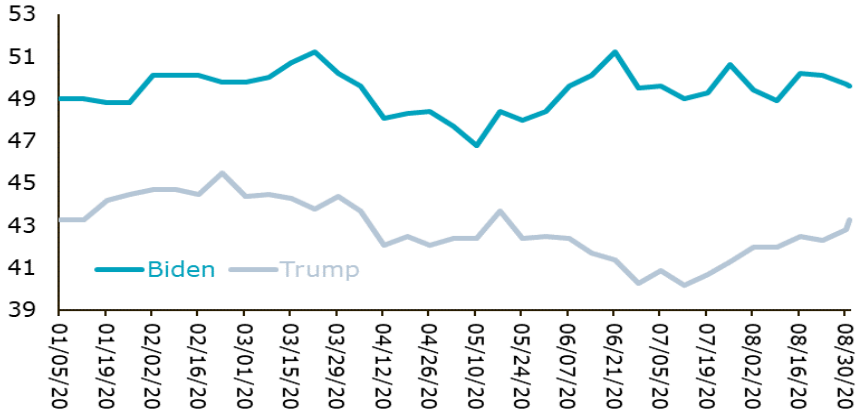
United States

US economy: the recovery continues



Source: Bloomberg, Robeco

US election: Trump is gaining on Biden



Source: Real Clear Politics, Bloomberg &Robeco

> The Fed has shown a strong willingness to support the US economy and keeping rates low for a long period of time is seen as an important tool to achieve this. Convincing the market that you will keep rates low is easy when inflation is below target. It's more difficult when inflation is above target. To prevent the market from anticipating rate hikes too soon, the market is given forward guidance. The Fed has chosen to do this by altering its inflation target. It is no longer sufficient that PCE reaches 2% in the longer run. Now, inflation needs to average 2% over a period. This implicitly assumes that after a period in which inflation undershoots 2%, the Fed will accept that inflation will need to be above 2% for the following period. We don't expect any changes to the Fed's assets purchase policy in the coming months.

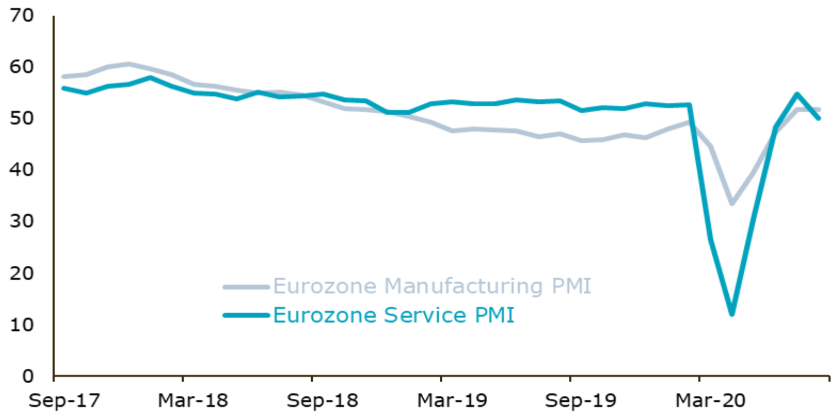
> We are about two months from the US presidential election and both parties have held their conventions. We expect the campaigning to really take off from here. Biden still leads Trump in the polls, but his lead has narrowed. The reason the incumbent president is in trouble is clear: the economy isn't in great shape, with unemployment still in double digits. Further, Trump's handling of the pandemic and social tension hasn't been great. What would be helpful for Trump is better news flow on the pandemic and the passing of a new fiscal passage.

> What is noticeable is that while Biden still leads on a national level in key battleground states, he not polling better than Hillary Clinton did. This is something to watch, because in contrast to the previous elections, people know what kind of president Trump is. If Biden is unable to win massively in those states, it should be a warning sign. As we all know, US elections are not so much about winning the popular vote but more about winning the swing states.

All data to 31 August unless mentioned otherwise

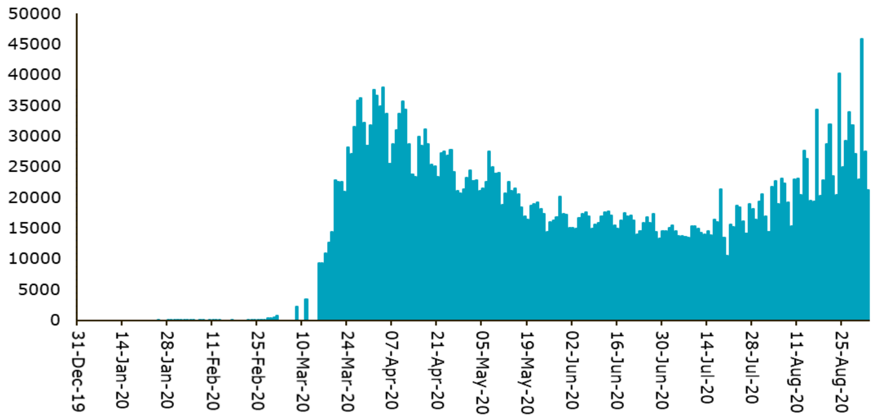
Europe

Recovery continues but at a slower pace



Source: Bloomberg, Robeco

Europe: the number of infected has increased in past weeks



Source: Bloomberg, Robeco

> At its latest governing council meeting, the ECB left both its key policy rates and its forward guidance unchanged. The meeting was used to underline its commitment to the current policy measures. Bond purchases will be made under the pandemic emergency purchase program (PEPP) until the end of June 2021, and principal payments from maturing bonds bought under this program will be reinvested until the end of 2022. The ECB also remains ready to adjust all its instruments if it deems this necessary. In the short term, we don’t expect the ECB to make massive changes to its policy. Two things might trigger a change of policy: if a resurgence of the coronavirus spirals out of control, or if the euro strengthens excessively. Still the initial reaction to either of these events will be an increase in dovish rhetoric.

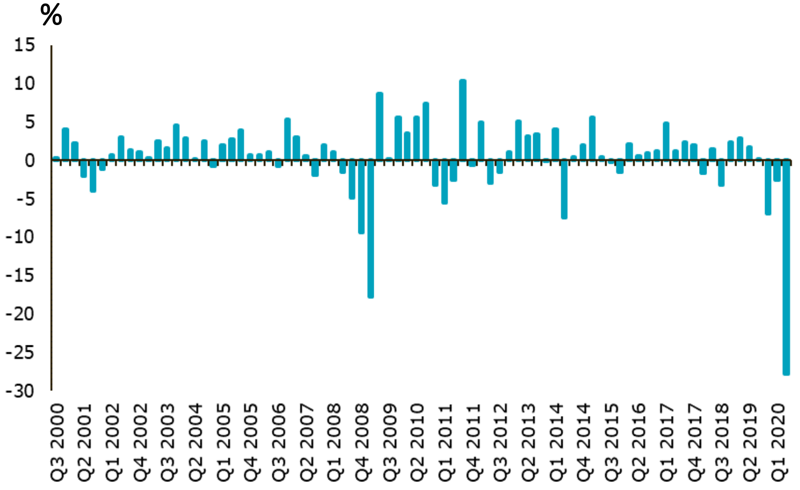
> After slowing down substantially, the numbers of infected people have started to increase again across Europe. While this increase is worrying, the good news is that the numbers of fatalities is substantially lower than during the first wave. Policy reactions to the resurgence is to control the outbreak through changes in behavior such as wearing face masks and more disciplined social distancing, coupled with modest, targeted and regional restrictions. This will hopefully be sufficient.

> The European economy continues to recover, though momentum is slowing. This was visible in the latest purchasing manager indices. Both the manufacturing and the services number came in softer and below expectations. What is positive is that both numbers remain above 50, still indicating expansion. It is comforting that consumer confidence is not deteriorating. The euro has strengthened but not sufficiently to start weighing on the economy.

All data to 31 August unless mentioned otherwise

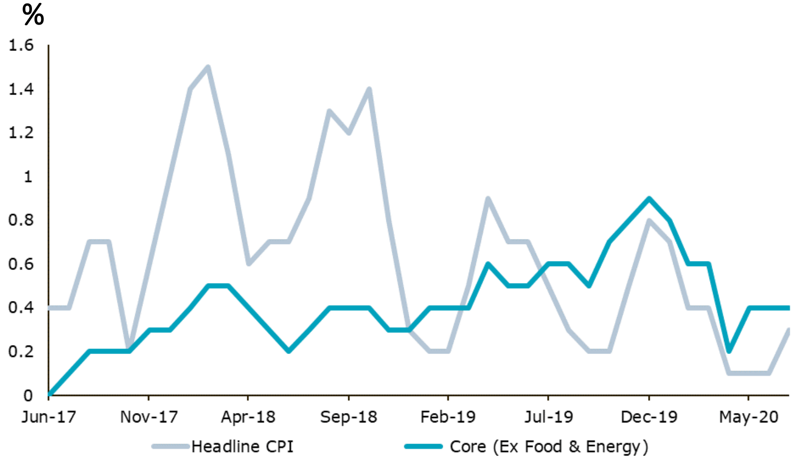
Japan

Japanese economy: GDP contracted 27.8% QoQ (SAAR)



Source: Bloomberg, Robeco

Inflation: core inflation is stable



Source: Bloomberg, Robeco

- The BOJ became slightly more optimistic about the Japanese economy, saying the recovery remains fragile but fluid. This slightly better assessment is based on a more optimistic view about consumption and a noticeable improvement of economies abroad. Inflation expectations remains bleak. The improved outlook is predicated on the absence of a major second wave of infections. Policy will continue to be targeted at providing bridge financing to the private sector. These emergency measures will remain in place if the recovery is slow and shaky. Prime Minister Abe announced he will step down for health reasons, though the founder of Abenomics indicated he will remain in office until a predecessor is appointed. As Abe's political party holds a majority in the lower house, the next party leader of the LDP will be the next prime minister of Japan. Given the current state of the Japanese economy, we don't think a change of leadership will lead to change in policy in the short term. We expect fiscal and monetary support to continue to be supportive.

- The economy contracted by a massive 27.8% QoQ in terms of the seasonally adjusted annual rate (SAAR) in the second quarter. In May, the economy bottomed, as industrial production, exports and consumption rebounded strongly. Currently, the economy is losing momentum, as the number of infected people has started to increase. The service sector is again bearing the brunt of this slowdown due to its domestic focus. A positive for the services sector is that consumer confidence only dropped marginally. Manufacturing on the other hand continues to recover nicely, as it benefits from the recovery abroad. The outlook for inflation remains poor. The inflation index excluding both energy and fresh food – the gauge preferred by the BoJ – remained at 0.4% year-on-year and is far below the target of 2.0%.

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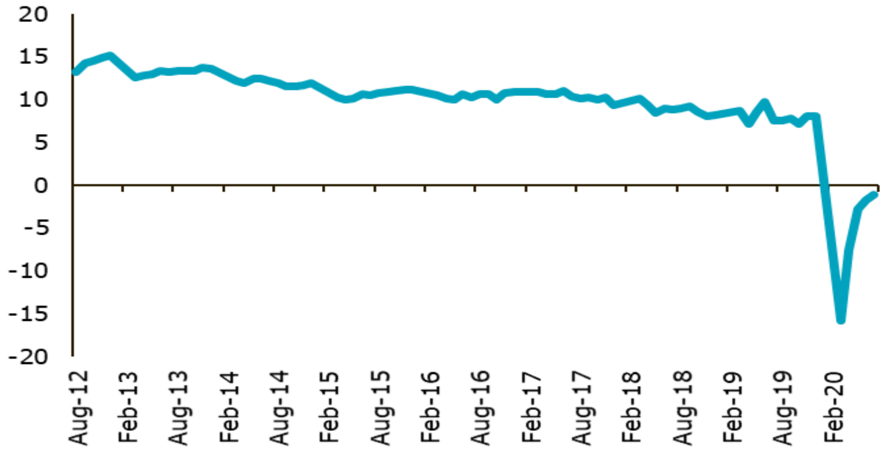
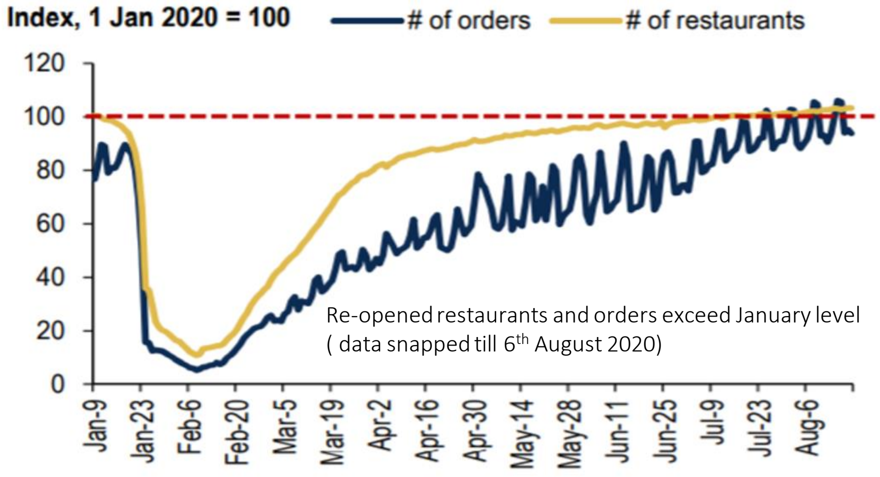
China

China: retail sales (YOY) are still contracting but only marginally



Source: Bloomberg, Robeco

Service sector: high frequency data is pointing to improvement



Source: BofA Global Research , Hualala.com

> The PBOC seems less worried about the recovery and has moved to a less dovish stance. Its appetite for lower reserve rate requirements and rate cuts has lowered and its preference now is for targeted easing aimed at lowering bank lending rates (particularly for SMEs). However, sustaining private sector credit growth will most likely require lower rates and further cutting the reserve ratio for smaller banks.

> So far it looks like China has been able to prevent the coronavirus from meaningfully resurfacing. This has enabled the economy to continue to recover nicely. A drag on the economy is still on the consumer side. Retail sales again contracted on a year-on-year basis, although only by 1.1%. The labor market also has yet to fully recover. It is estimated that the number of migrant workers employed compared to a year ago is still around five million less. What is encouraging is that high frequency data is pointing to a strengthening service sector. Tourist trips are rising (domestic travel), food orders surpassed January's level, and cinema box office revenues are rising.

> Infrastructure investment, credit growth and exports all came in stronger, although the first two were weaker than expected. Industrial production grew at a healthy clip of 4.8% year on year, in line with the previous month. Property activities continue to be robust while manufacturing investments remain weak. This weakness is set to remain, as the sector is faced with several uncertainties such as geopolitical tension between China and the US, while Covid-19 has stressed the importance of supply chain continuity. While the rhetoric of the US towards China hasn't softened, it looks like that both parties are still honoring the phase one trade deal, even though China has not fully delivered on purchasing the agreed quantity of US goods.

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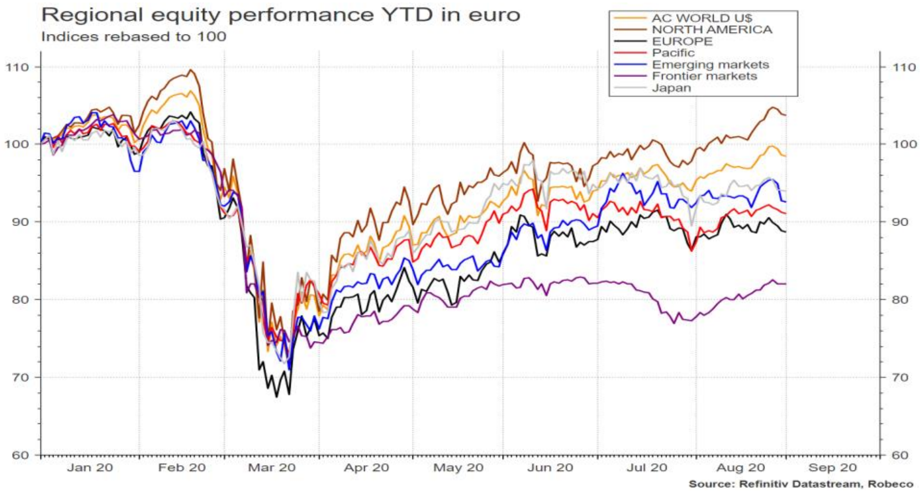
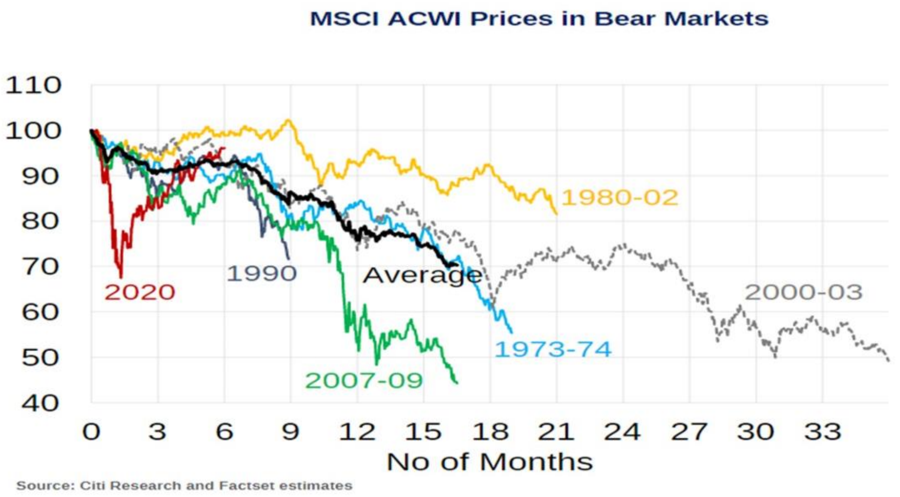
Equities (I)

An impressive rebound continued in June



Source: Refinitive, Robeco

New bull market, or a bear market rally?



Source: Citi Research

- Equities posted another strong month, with the MSCI World Index (in euros) rising 5.5%. The US and Japan were the best performing regions, while European equities lagged, as doubts of the strength of its economic recovery rose. In the year to date, US equities remain the clear leader, as technology stocks continue to outperform.
- With the risks on the upside and downside fairly balanced, and the relative attractiveness of equities compared to corporate bonds increasing, we now hold a close-to-neutral position in equities. Also, compared to earlier major bear markets, equities have now come to a point where it could go both ways.
- One of the reasons for equities to continue to grind higher is the increasing containment of the Covid-19 outbreak. While we are witnessing second waves in Asia and Europe, better tracking, testing and treatment mean fewer hospitalizations and deaths, reducing the odds of new lockdowns. Increased testing and tracking also means that the number of new cases reported is much closer to the real number of infections. This was certainly not the case a couple of months ago, when the reported number of cases was only the tip of the iceberg. In addition, we are getting closer to the announcement of a working vaccine.
- The ongoing recovery of the global economy accompanied by massive amounts of central bank and fiscal stimulus should benefit equities as well. More than other asset classes, equities at times have the ability to discount the anticipated good news flow way too far into the future. We believe such a period is developing now as animal spirits are returning to the markets.

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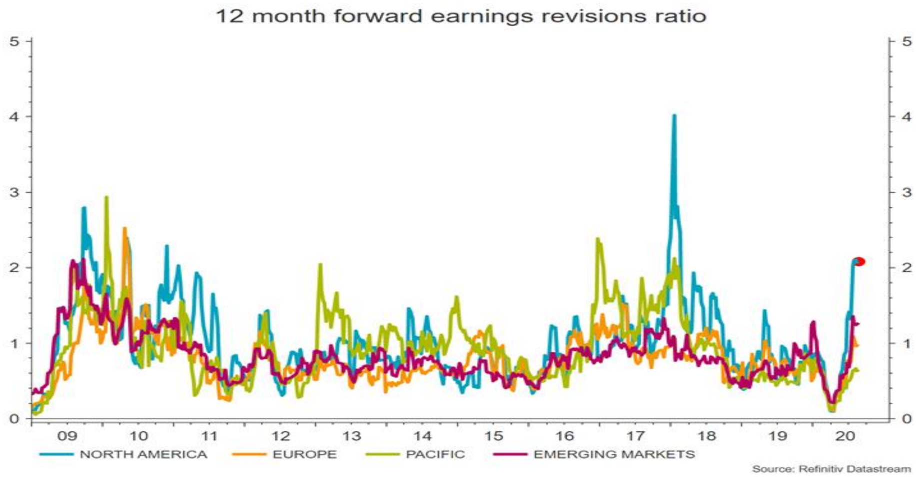
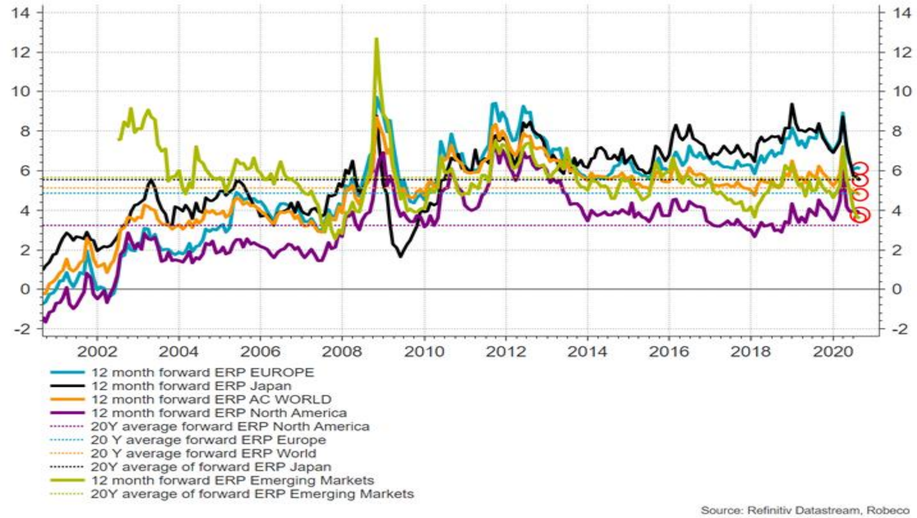
Equities (II)

How deep is the trough? Q2 earnings will tell



Source: Refinitiv, Robeco

Strong compression in equity risk premiums



Source: Refinitiv, Robeco

> Earnings revisions continue to improve, especially in the US. Equities tend to grind higher when earnings revisions are improving. From a regional perspective, Japan lags in the earnings recovery thus far.

> Yet, it would be a mistake to assume that there are no catalysts that could dent investor sentiment. Quite the contrary, we believe that risks remain abundant, which warrants only a neutral stance at this point in time.

> The US elections are an important example of geopolitical risk, with Trump bouncing back in the polls. China-US tensions, which have increased, continue to linger as well. Lackluster consumer confidence related to a slow and uneven recovery in the labor market could dampen the recovery, and market breadth remains narrow (it's all about technology). All could negatively impact sentiment.

> If one of these catalysts occurs, lofty valuations are likely to become an argument to sell equities as well. On a standalone basis, equities are richly valued on most metrics, although on a relative basis, valuation is not that high. Yet, some exuberance is appearing in some segments of the equity market.

> We keep a close to neutral weighting in equities in the multi-asset portfolio as we believe the risks are fairly balanced. Within developed market equities, we don't have a regional preference. US equities are more expensive, but also enjoy the unprecedented positive momentum of tech stocks. Exposure to the global recovery is higher for European and Japanese equities, but higher currencies and some loss of economic momentum do not warrant an overweight.

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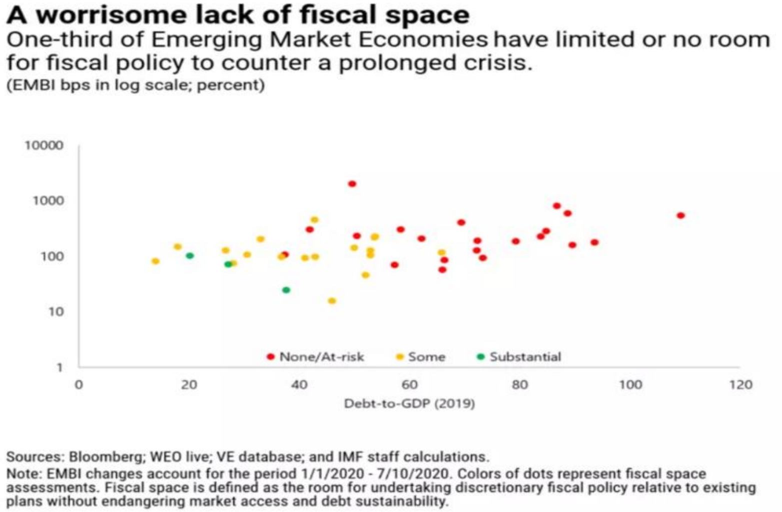
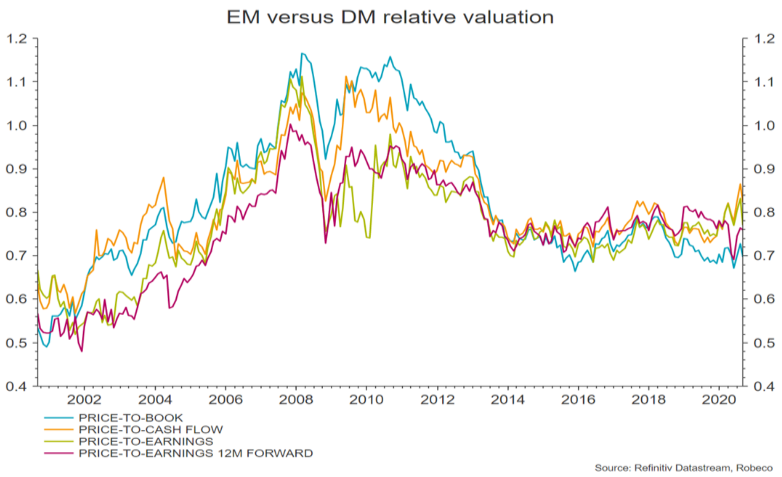
Equities (III)

Emerging markets: less room for fiscal stimulus



Source: World Economic Forum

Valuation: emerging versus developed markets



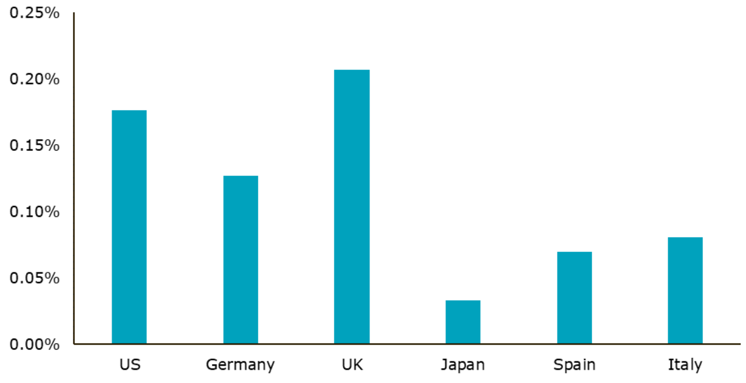
Source: Refinitiv Datastream, Robeco

Emerging versus developed

- Emerging market equities (in euros) realized a positive return of 1.1% in August, lagging the MSCI World Index.
- Emerging economies look more vulnerable to the impact of the Covid-19 virus outbreak and a potential setback in the global recovery. First, because many countries such as Brazil and India are still coping with high numbers of Covid-19 cases. Second, because overall stimulus is less than in developed countries, and is unlikely to catch up.
- However, a number of developments warrant a neutral stance on the asset class within the multi-asset portfolio. First, the US dollar has weakened significantly, improving foreign debt positions and growth potential.
- Related to this, we expect commodity prices to rise, as they reflect the lowest economic recovery compared to other asset classes. There is a clear and significant positive correlation between emerging equities outperforming developed market equities, and higher commodity prices.
- Finally, China, which is already ahead in the recovery, is likely to be a driving force for global growth, and we believe this will benefit Asian emerging economies as well. Recent PMI data confirms activity continues to grind higher.
- Despite intrinsic vulnerabilities to economic setbacks, a weakening US dollar, rising commodity prices and Chinese strength help foster a neutral position on emerging market equities.

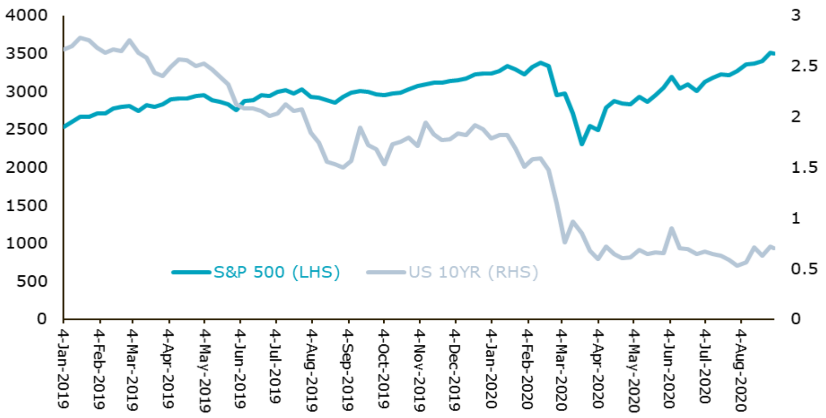
AAA Bonds (I)

10-year yields: rising across the board in August



Source: Bloomberg & Robeco

Who is right: equities or bonds?

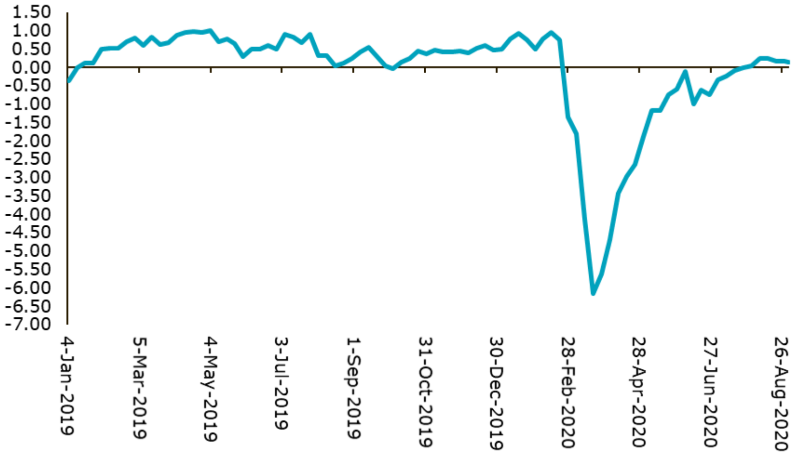


Source: : Bloomberg & Robeco

- August was the month in which the continuous meandering lower of bond yields suddenly came to a halt. Most 10-year yields remain below the levels at which they started the year. The reversal in August is by itself not meaningful enough to conclude that this is the beginning of a trend change. However, the events that probably triggered the jump higher in yields are important enough to consider the possibility that yields have reached an inflection point.
- For some time now, a disconnect has opened between equities and government bonds. Equities continue to move higher while bond yields continue to move lower and lower. The move in equities mirrored the pick-up in activity we witnessed as economies started to reopen. Equities moved in line with the improvements in purchase management indices that we saw worldwide. Bonds, however, didn’t and remained dismissive of the improvement in economic data.
- A reason for this disconnect could be that the global recession was self-induced. It wasn’t triggered by an excessively levered corporate, consumer or banking sector: it was a consequence of a deliberate choice to stop halt the pandemic. As the cause of the recession was atypical, could it also be that the recovery will also be atypical?
- The most noticeable difference with previous recessions is the support provided to revive crippled economies. The size of this support was unprecedented, as it was not only provided by central banks, but also by governments. Also, the support wasn’t just focused on supporting financial markets, but also directly targeted at supporting the real economy. This has come close to what former Fed chairman Bernanke once referred to as ‘helicopter money’.

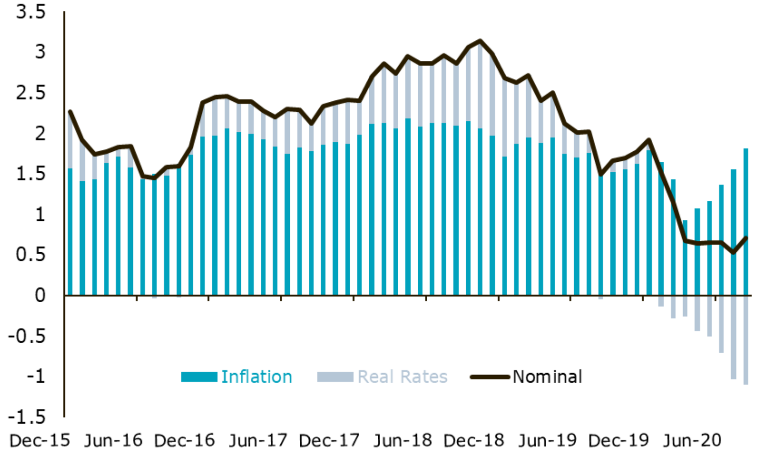
AAA Bonds (II)

Us financial conditions: stalling but still supportive



Source: Bloomberg & Robeco

US 10-year: inflation expectations are the dominant driver



Source: Bloomberg & Robeco

> The way the support programs were structured creates opposing forces on yields. The necessary increase in bond supply to pay for the government support programs creates upward pressure on yields. The programs support economic activity, and thereby sustain inflation expectations and increased risk premiums to entice buyers to absorb the extra supply. On the other hand, central bank bond-buying programs pressure nominal yields lower. Debt monetization by itself should be a worry for bond markets, as it removes the market's power to discipline the spending of the government, which by itself should lead to higher risk premiums.

> The market is struggling to discount the impact on yields of the different forces. In the US, the guidance provided by the Fed chairman at Jackson Hole seems to be tipping the scale towards higher inflation. Average inflation targeting and the goal to pursue full employment, and the absent appetite of FOMC members for yield curve control, look to be tipping the scale for a tolerance for higher inflation. So, higher inflationary pressure on yields looks warranted. The escape hatch for this will be both nominal yields and real yields. As US yields remain the global benchmark, we think that globally, yields will feel the pressure. The sustainability of this upward pressure is off course also dependent on the appetite for risk. Geopolitics and lingering pandemic fears all could quickly impact this. If for what ever reason the market gets nervous, safe havens like bonds will quickly come into vogue again.

> We currently don't have a strong view on yields. We feel comfortable to be underweight government bonds against investment grade corporate bonds.

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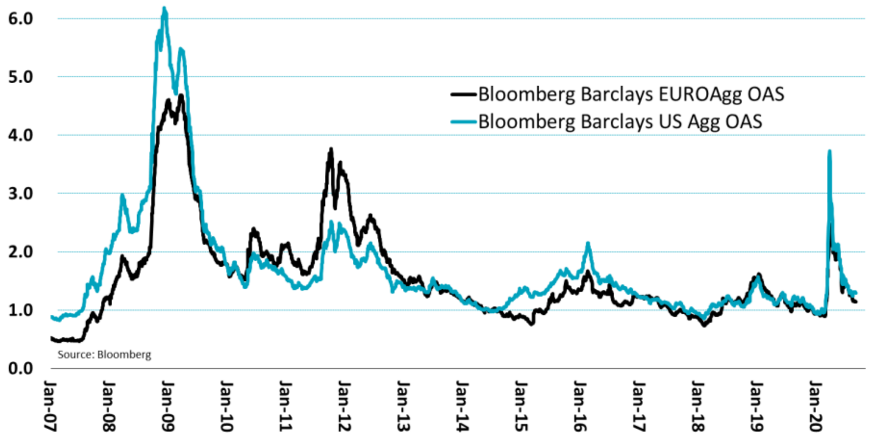
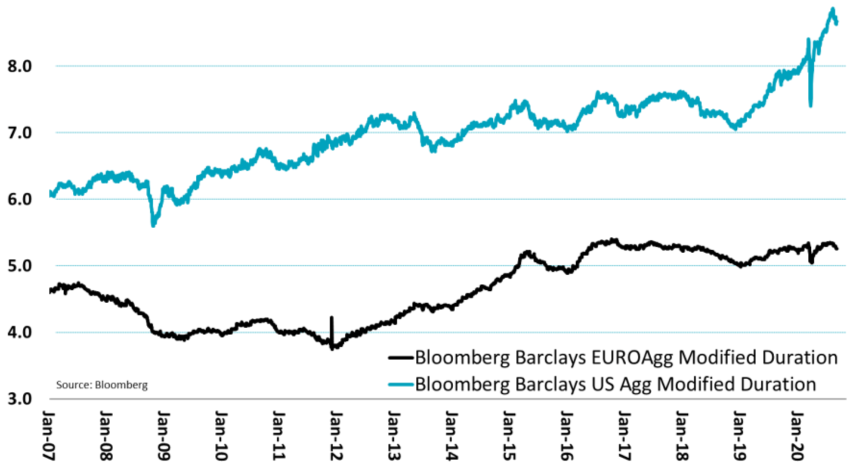
Investment Grade Credits

Investment grade credits: spreads in the Eurozone and US



Source: Bloomberg, Robeco

Investment grade credits: duration in the Eurozone and US



Source: Bloomberg, Robeco

> In August, global investment grade bonds realized their first negative calendar month return (-0.8%) since March, even as the index stayed above the previous peak of early March. During August, we have significantly reduced our overweight in the multi-asset portfolio and moved into a more neutral positioning.

> With the average spread level on global investment grade bonds down almost 200 basis points to 130 basis points and a 14% return from the low in March, we believe the time has come to take profit on our aggressive allocation. We believe a somewhat elevated spread level is warranted given the high amount of economic uncertainty now that the low-hanging fruit in this recovery has been picked.

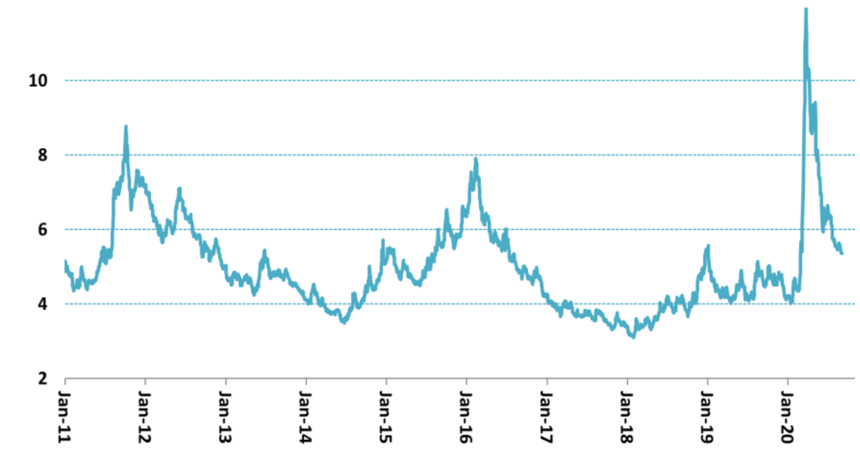
> In addition, as a result of another leg down in bond yields around the world caused by a massive amount of monetary stimulus, duration risks have increased. The average duration on global investment grade bonds has risen by almost a full year since the market bottomed in March to a lofty 7.4 years. This is the highest duration on record for our reference index. Most of this is explained by a rise in the duration of US investment grade bonds, which equaled no less than 8.7 years at the end of August. A pretty significant shift from spread to duration risk, which we do not necessarily like, has taken place the last couple of months

> The asset class does still offer value against government bonds, however. Government bonds come with even more duration risk, and their valuation is unattractive. Further recovery of the global economy is positive for spreads, but most likely not for duration. Hence, we have neutralized our overweight of investment grade bonds except relative to government bonds.

All data to 31 August unless mentioned otherwise

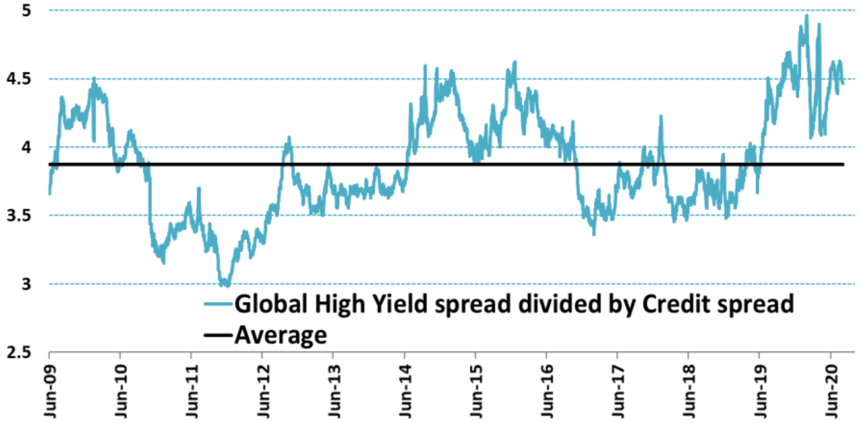
High Yield

Global high yield: average spread



Source: Robeco & Bloomberg

High yield bonds: spread relative to investment grade



Source: Robeco & Bloomberg

> Global high yield bonds realized a return of +1.3% in August, bringing their total return since the March low to above 25%. With spreads tightening significantly – the spread on global high yield bonds averaged 546 basis points at the end of July – and economic uncertainty still abundant, we have significantly reduced our overweight.

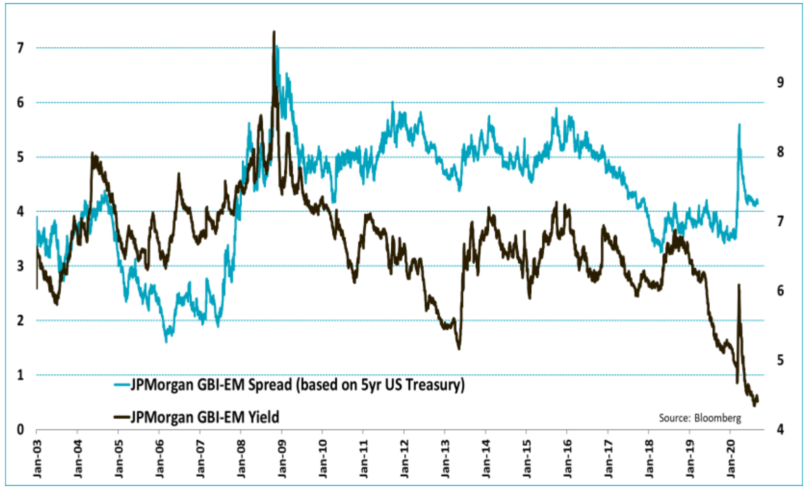
> As the chart on the top left shows, the average spread level of global high yield bonds has tightened by more than 600 basis points from the peak of more than 1,200 basis points. While this is still above the long-term average, we believe that a somewhat elevated spread is warranted, as default risks continue to linger. In addition, historically the performance of high yield bonds starts to lag the performance of equities (on a risk-adjusted basis) when spread levels dive below the 600-basis point threshold.

> Despite reducing the weight of high yield bonds in the multi-asset model portfolio, we are sticking to a small overweight. The total yield of roughly 6%, we believe, is enough to keep attracting investors looking for yield. Central banks continue to buy corporate bonds and will continue to do so if economic circumstances deteriorate.

> Also, contrary to investment grade bonds, duration risk has not increased much in recent months. A final argument to remain marginally overweight is that history shows that even after a significant tightening during the peak of the economic crises, the asset class tends to continues to perform strongly for at least the next 12 months.

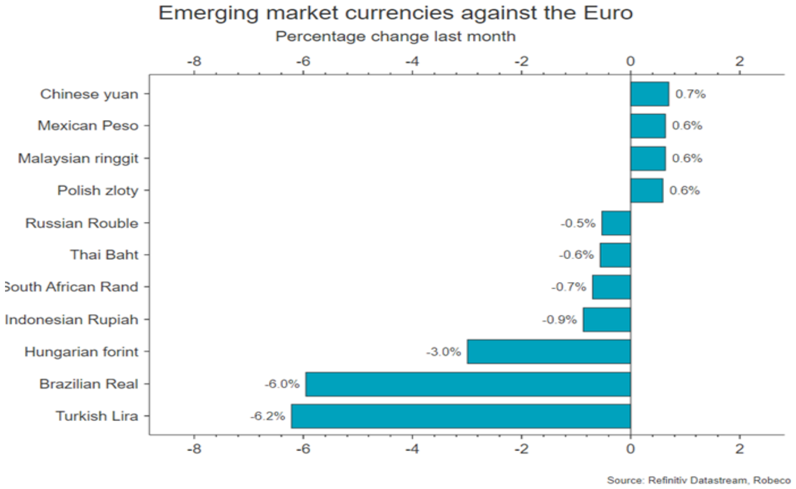
Emerging Market Debt

Emerging market debt in local currency: spread and yield



Source: Bloomberg, Robeco

Emerging market currencies against the euro



Source: Thomson Reuters. Refinitiv Datastream, Robeco

> Local currency emerging market debt (to which we are underweight) realized a positive return of 0.5% in euros in August, lagging the performance of global high yield bonds (to which we are overweight).

> As in previous months, the stronger euro accounted for much of the lagging performance of local currency emerging debt. On average, currencies fell by 1.5%, led by the Brazilian real and the Turkish lira. These countries, which already looked vulnerable going into the Covid-19-induced recession, have come under serious scrutiny by investors, leading to currency depreciation. Both countries are projected to have relatively large budget deficits, with Turkey also still dealing with high numbers of Covid-19 cases.

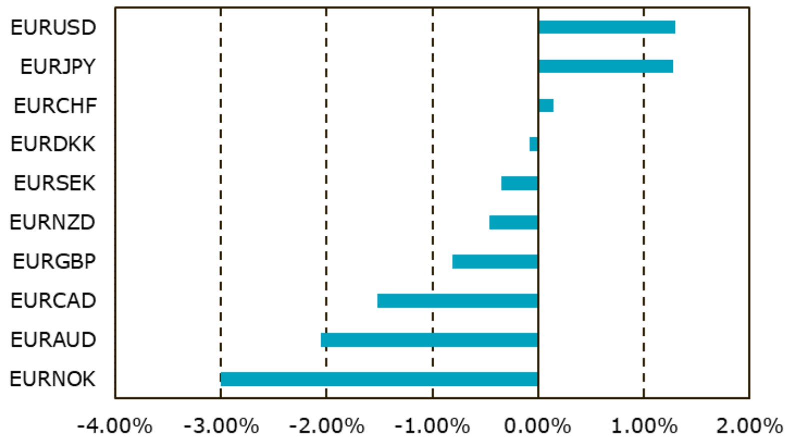
> Contrary to developed markets, big fiscal deficits are not matched by big amounts of central bank bond buying. As a bloc, emerging countries have less room for further stimulus compared to developed countries. In case of a (temporary) setback in the global recovery, emerging currencies should remain vulnerable.

> Meanwhile, at 4.50%, the current yield is close to an all-time low. This means there is little buffer if emerging currencies should weaken. Compared to high yield, the yields also look less attractive. In addition, whereas developed market central banks are likely to step in during a crisis, such as by expanding the eligible universe for bond buying, there is no automatic stimulus-related ‘protection’ for emerging currencies. In fact, emerging market central banks might be inclined to weaken their currencies to improve competitiveness.

> We remain underweight in local currency emerging market debt.

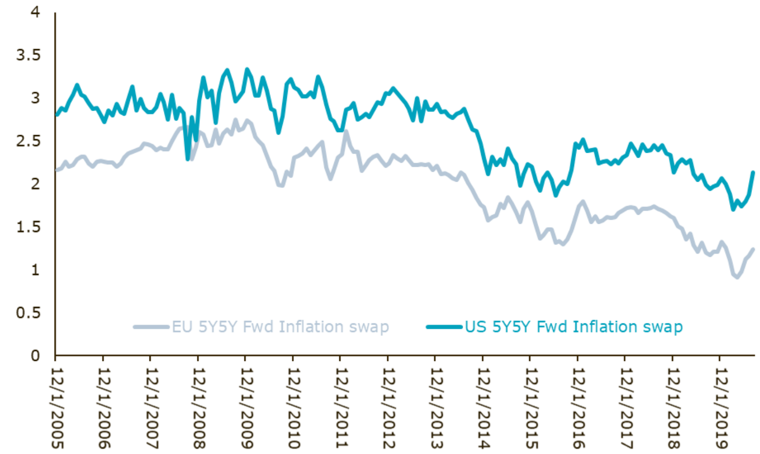
FX (I)

G-10 currencies: cyclical currencies keep leading the way



Source: Bloomberg, Robeco

Inflation: rising expectations



Source: Bloomberg, Robeco

- After moving strongly higher against the US dollar in July, the euro consolidated in August. While moves in the EUR/USD exchange rates always get a lot of attention, the euro wasn't even in the top three best-performing currencies within the G-10. The top performers were the commodity/cyclical currencies. These continue to benefit from robust commodity demand out of China and the slowly improving global growth backdrop. The laggards of August were the defensive/safe haven currencies.
- Growth slowed in Europe last month. While this slowing in the pace of growth was a global phenomena, it was quite visible in the Eurozone. Confidence across the continent took a hit, due to the resurgence of the virus during the summer. This may weigh on the euro in September.
- The moves in the FX markets broadly reflected what also has been playing out across financial markets. The best-performing asset classes were the more cyclical ones such as equities and commodities – the S&P 500 even made a new all-time high in August – while the laggards were the more defensive ones such as government bonds.
- The themes that are currently playing out in the foreign exchange markets look set to continue. For game changers, we mainly need to look towards the US. The passing of a fiscal package, the US election race, China-US tensions and the implication of the new Fed framework could all change the dynamic of the markets. While the recent announced departure of Japanese PM Abe was a surprise, we don't think this will lead to a massive shift of the policy mix in Japan.

All data to 31 August unless mentioned otherwise

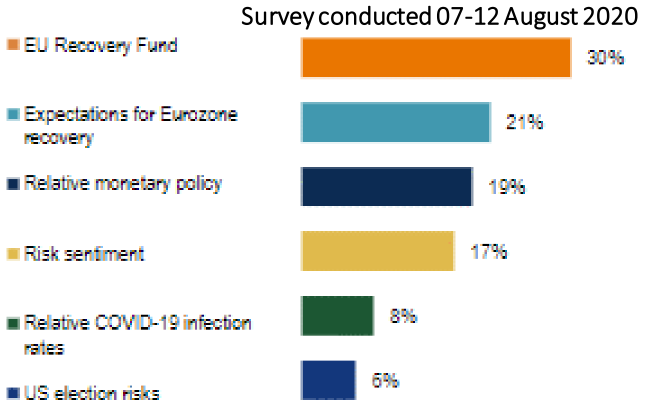
ROBECO

FX (II)

The euro: expensive but not extremely so

Source: ECB , Robeco

What is driving the EUR/USD?



Source: BofA Global Research FX and Rates Sentiment Survey

- The UK is finally starting to recover. After the economy declined by 20.4% QoQ in the second quarter, we are stating to get some positive news from high frequency data. Both retail sales and the ISM are pointing to a vigorous rebound of the UK economy. Still, we don't think that this improvement in the numbers was the main driver of the performance of sterling this month; the main driver remains Brexit negotiations. The prospect of a skinny trade deal was a major positive for the market in what are still seen as tedious negotiations.
- Over the past period, inflation expectations have risen across the board. With nominal yields barely moving, the biggest impact of rising inflation expectations was mainly on real yields. Differences in real yields became an important driver of currencies, and the US dollar was the main casualty of this.
- Although the euro already has strengthened quite a bit against the US dollar, our preference continues to be overweight the euro at the expense of the greenback. We acknowledge that that fundamentals have turned less supportive. From a valuation standpoint, the euro isn't extremely cheap anymore. Also, the market has by now fully discounted the lower break-up risk due to the establishment of a recovery fund by the European Commission. Going long on the euro now also looks to be a consensus position - something which is corroborated by several position indicators. What is positive is that the ECB has so far not expressed major concerns about this appreciation. The implicit tolerance for higher inflation by the Fed due to its new policy framework should also be a drag on the US dollar.

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