ROBECO
The Investment Engineers

Multi-asset market outlook

COP27: A few wins have been claimed

December 2022

For professional investors

Sustainable Investing Expertise by
ROBECOSAM

General overview

Emerging markets roar back

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Emerging Markets (LC)	11.7%	-1.5%	-13.8%	-12.5%	2.7%	2.2%
Emerging Markets (UH, EUR)	10.2%	-4.1%	-10.5%	-9.7%	2.5%	2.5%
Gold (USD)	6.8%	2.1%	-4.7%	-1.9%	4.6%	5.4%
MSCI World local currency	5.7%	3.8%	-11.5%	-8.0%	8.4%	8.2%
MSCI World (H, EUR)	5.4%	3.0%	-13.4%	-10.0%	6.8%	6.4%
Global real estate (UH, EUR)	4.2%	-6.3%	-14.9%	-10.0%	0.3%	4.0%
Global investment grade bonds (H, EUR)	4.0%	-1.8%	-15.6%	-15.7%	-4.0%	-1.3%
Global high yield (H, EUR)	3.9%	0.6%	-13.2%	-11.9%	-2.2%	-1.0%
EMD hard currency (UH, EUR)	2.7%	-2.2%	-8.9%	-8.8%	-2.1%	1.7%
MSCI World (UH, EUR)	2.7%	1.5%	-5.6%	-2.6%	10.0%	10.5%
EMD local currency (UH, EUR)	2.5%	-1.8%	-3.1%	-3.0%	-2.3%	1.3%
Global inflation-linked bonds (H, EUR)	2.5%	-4.2%	-16.8%	-18.3%	-2.3%	-0.6%
Global Gov Bonds (H, EUR)	1.8%	-2.1%	-12.3%	-13.1%	-4.0%	-1.5%
Cash (EUR)	0.1%	0.2%	-0.1%	-0.1%	-0.4%	-0.4%
Oil Index (USD)	-5.6%	-6.5%	27.8%	45.7%	-3.0%	-1.6%
GSCI Commodities (USD)	-5.6%	-5.6%	41.1%	50.3%	16.1%	10.9%

Source: Robeco, Bloomberg

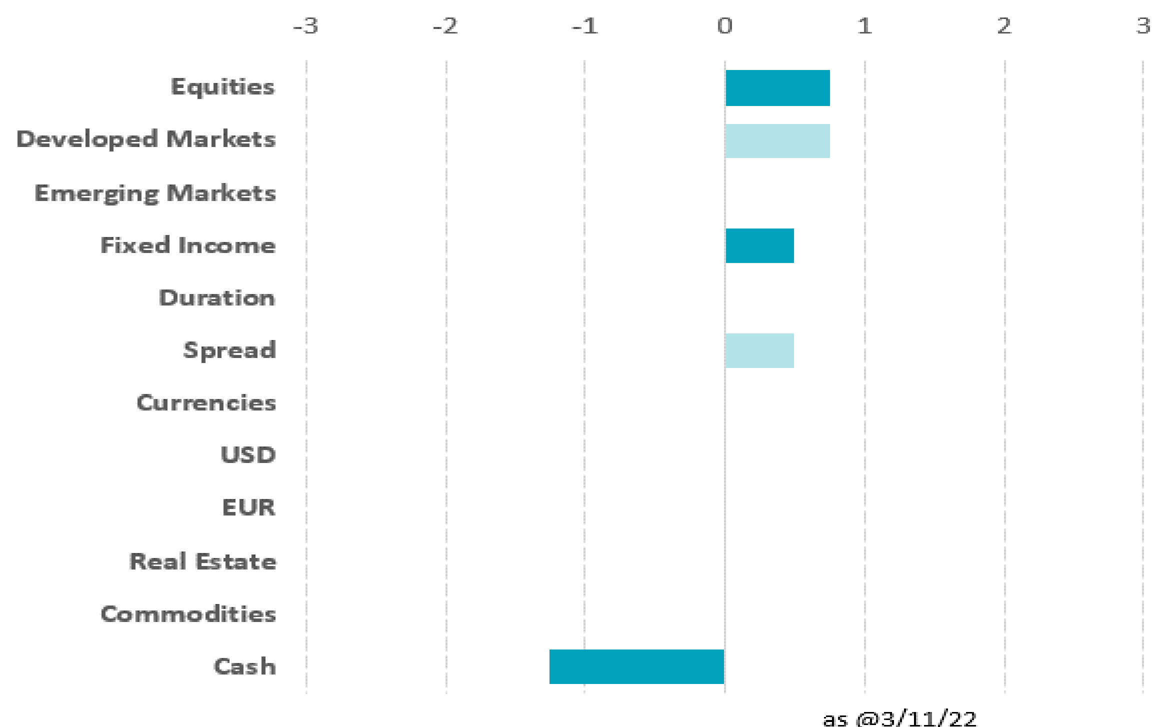
The Fed sounded more dovish in November as the US central bank seemed to start to acknowledge the cumulative lagged impact of the recent tightening of its inflation and growth objectives. Other central banks around the world have also shown more reluctance to keep their aggressive tightening pace. A speech by Fed Chairman Powell indicated that Fed rates likely were ending up "somewhat" above the 4.6% FOMC projection made in September, also hinting at a slower rate-setting pace from December onwards. However, central banks in developed economies remain very much data dependent, and Powell also later reiterated the policy goal not to overtighten monetary policy in order to prevent a steep rate-cutting cycle.

In China, investors clearly jumped on the 'end of zero Covid policy' bandwagon and the easing of the Chinese real estate crackdown. Emerging market equities in local currency surged 11.7% in November, spurred on by Chinese equities (+29.%). All assets were lifted by the anticipation of a more measured pace of future tightening by central banks. Commodity prices declined by 5.6% in November. Within fixed income, yields compressed across the board, with the exception of Japanese government bonds. Strong market appetite was visible for European credit (high yield Europe gained 3.6%) and US investment grade (+5.2%, unhedged in USD). In currencies, the Brazilian real was the largest mover against the euro, losing 5.5% in November.

 All market data to 30 November unless mentioned otherwise

Multi asset views

Sustainable multi asset views



Source: Refinitiv Datastream, Robeco

What we are witnessing today in our view is a countertrend rally that only corroborates with the historical evidence of a prolonged bear market. We have been benefitting from this by being overweight equities and high yield, as we believe that investors were excessively bearish in October, with a lot of cash standing on the sidelines. At the time of writing, momentum and seasonality are still supportive to seeing some further gains in the equity market towards the year end. The turn in Chinese policy towards Covid might continue to support markets, as well as a weakening dollar bull market. The economic outlook for China could brighten in H1 2023 against the prospect of the end of the zero Covid policy by Q2 2023 (or earlier) and cheap Russian energy imports. Further down the road, the economic upside seems capped by a more measured domestic credit impulse, wary domestic consumers and a US economy that is more likely to enter a recession by H2 2023.

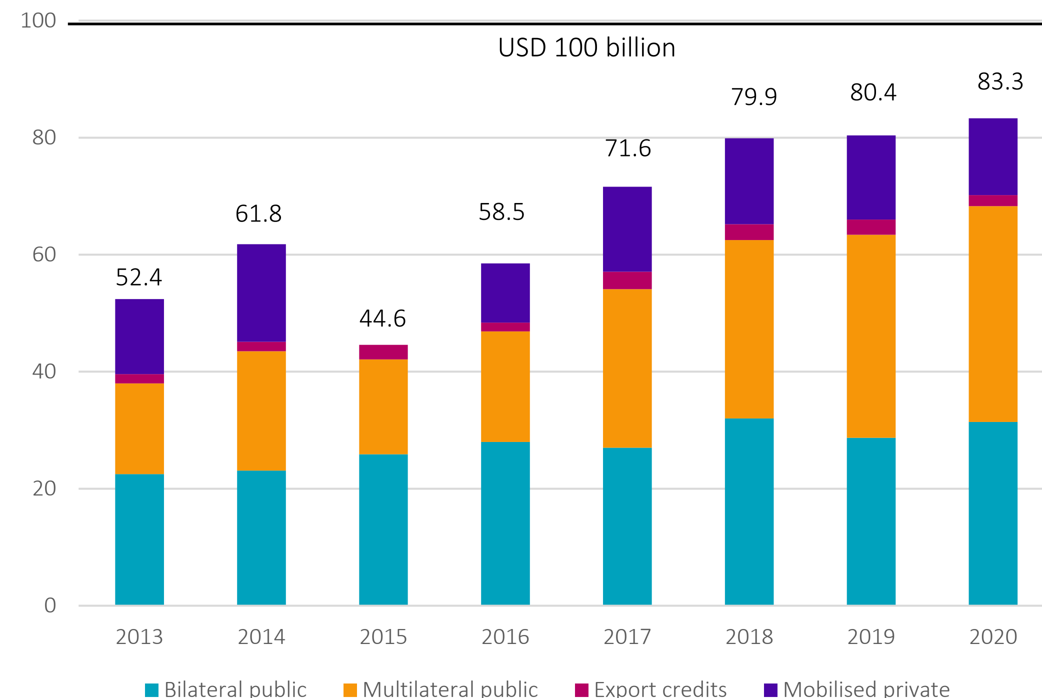
We maintain a modest risk-on stance towards the year-end, with an overweight in equities and high yield. A tactical overweight in bond duration also added alpha, although profits have now been taken from this position. With core inflation still well above target in the first half of 2023, the peak in yields and the dollar that we envisage might be further out, especially if the energy crisis lingers. We think a hard landing will take the sting out of inflation and Fed futures in December 2023 will be below their current pricing of 4.75%.

Theme of the month

COP27: A few wins have been claimed

Many leaders around the world have stressed the urgency of delivering on commitments to tackle climate change during this year's COP27, and although results have fallen short of any significant progress, there have been a few wins claimed along the process. On the one hand, not much was achieved on commitments around reducing carbon emissions. Based on the latest climate action tracker published in November, only 29 countries have submitted NDCs (nationally determined contributions) updates in 2022, with five countries indicating stronger targets. On the other hand, there was recognition that developing countries need larger financing flows to tackle climate change, given that historically these have fallen short of the previously stated target of USD 100 billion per year (OECD). To that end, the decision to establish a dedicated fund to address the 'loss and damage' compensation for countries that have suffered and are likely to suffer climate disasters highlights good progress on supporting less-developed countries that bear the brunt of climate change.

Climate finance for developing countries



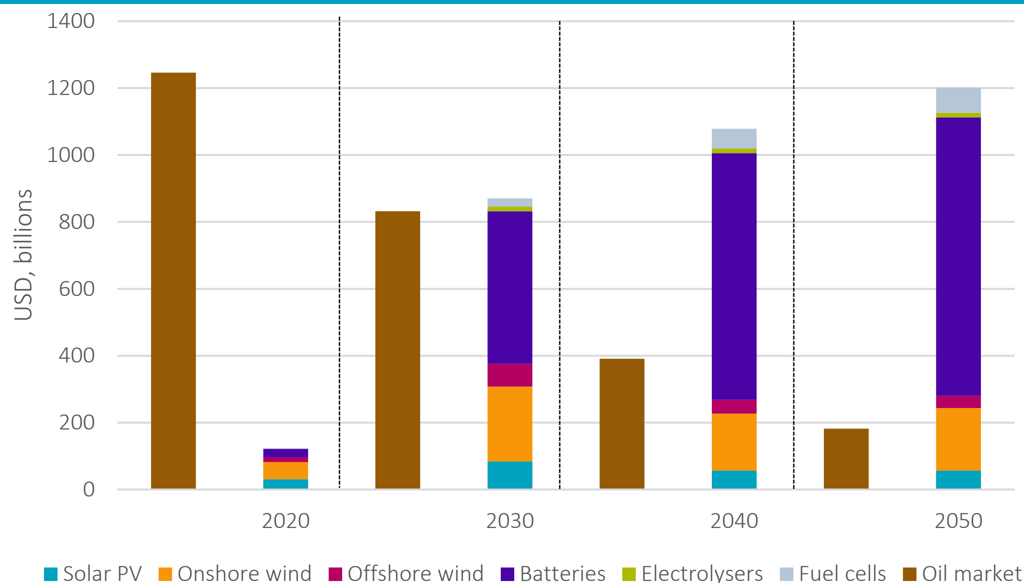
Source: OECD (2022)

In a similar vein, the USD 20 billion support package for Indonesia over the next three to five years, led by the Just Energy Transition Partnership, could set the scene of how private and public sector commitments could work towards supporting countries to cut emissions and transition from coal to renewable alternatives in line with their stated policies on achieving carbon neutrality. This could pave the way for similar initiatives that could work alongside a growing ESG debt market to finance the transition.

All market data to 30 November unless mentioned otherwise

Theme of the month

Estimated market sizes of oil and selected clean energy technology equipment in the Net Zero Scenario, 2020-2050



Source: IEA ,Robeco

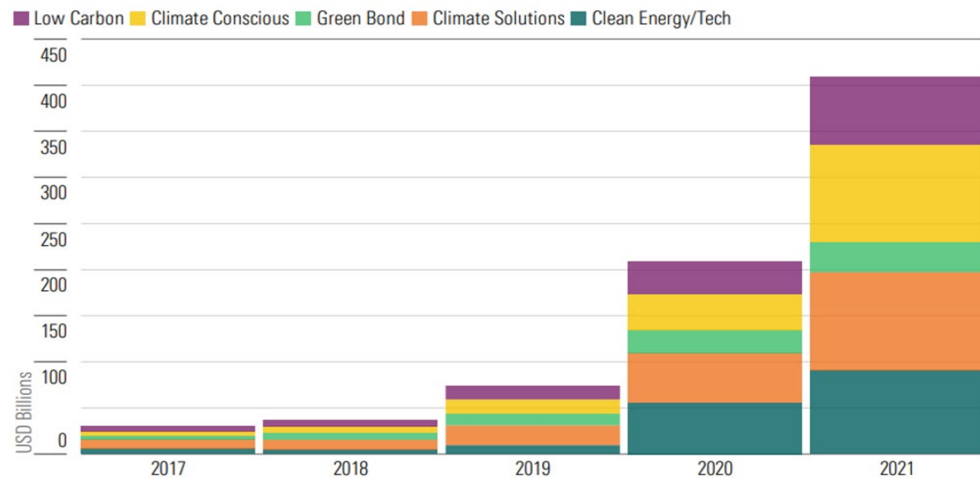
Faster adoption of renewables technologies needed to support future emission cuts

In the short term, the biggest challenge for developed markets is adjusting to the shift from energy transition to energy security, as high inflation rates have dominated the policy agenda, especially in Europe where the impact of the Ukraine-Russian war has been more pronounced. Plans to expand LNG capacity as a substitute to the lost Russian gas supply are viewed as incompatible with meeting 1.5°C, according to the IEA's net zero 2050 scenario. Countries will need to deliver more on the policy front and support the faster adoption of renewable initiatives in areas like clean energy and electric vehicles as a balancing factor to deliver the required emission cuts. For now, initiatives like the IRA (inflation reduction act), the Fit for 55 package and the REPowerEU plan set good examples for policymakers to tackle some of the short-term challenges that help accelerate the transition towards a cleaner energy mix.

Mitigating climate change through reducing carbon emissions will need coordination at a global level. Political pathways and investments in new technologies along with changing corporate and consumer behaviour will create opportunities for investors to participate in the transition. The recent energy crisis has accelerated commitments to renewable energy generation and renewable technologies which are becoming more cost competitive. According to IEA, the estimated market size of clean tech is expected to grow to USD 870 billion by 2030 under the net zero scenario. Growth in wind and solar is expected to average more than 10% per year over the next decade, whilst the size of the batteries market is estimated to grow at a 33% annualized rate. Geographically, North America and Asia Pacific are leading the way, but the recent geopolitical events in Europe have shifted the focus towards a faster development of green technologies there too.

Theme of the month

Assets in funds financing the energy transition have grown significantly



Source: Morningstar Direct. Morningstar Research. Data as of December 2021.

Risks and opportunities on the path to net zero

Against this backdrop, asset flows into funds with climate-related mandates have grown substantially, reaching USD 408 billion at the end of 2021 (Morningstar), with almost half of the AUM in climate solutions and energy/tech funds. These offer higher exposure to companies that are developing solutions to help reduce carbon emissions, or indeed invest directly in the renewable space like wind and solar, energy storage (batteries), and electric vehicle technologies. Those themes have exhibited good long-term performance. with 10-year annualised returns (as at end November) ranging between 10% and 16%, compared to 10% for the Global Equity index. Higher valuation multiples at segments of the renewable energy space could pose concerns for investors in the short term, but the expected structural growth on offer should be supported by regulatory forces and the need for a more diversified energy supply ecosystem.

Similarly, and despite the challenging market environment, the sustainable debt market has grown to USD 4.5 trillion as at Q3 2022 (IIF data), with emerging and frontier markets making up USD 624 billion. Green bonds which finance positive environmental impact projects constitute USD 1.6 trillion, or approximately 0.5% of the total global bond market universe. Although the composition of the market is tilted towards European issuers and higher exposure to corporate bonds relative to the traditional Global Aggregate Fixed Income Index, a recent survey by the World Bank indicates growing appetite for issuance of sovereign green bonds by emerging markets looking to finance climate action. The main impediments have been the lack of frameworks and a better understanding of the market structure, demand and pricing. On the other side, liquidity considerations, benchmarking the yield curve and best practices are top on investors minds when looking to mobilise private capital towards financing the transition in less-developed countries.

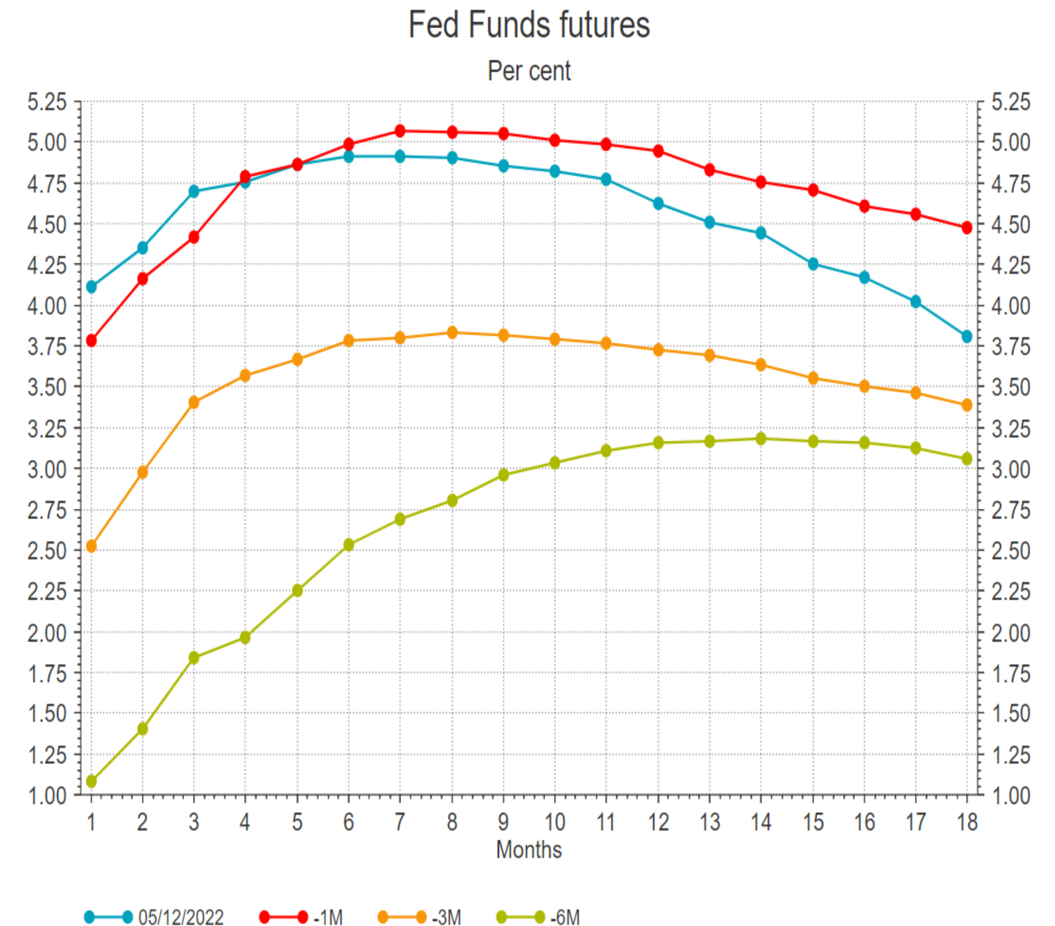
COP27 highlighted that political will is key to shaping the balance between climate ambition and implementation. In the long run, achieving energy security means investing more in green technologies and climate solutions to close the gap between ambition and implementation. More cost-competitive renewables and a growing green bond market should provide investors with opportunities on the path to net zero. Fine tuning between climate integration, liquidity and risk/return considerations is key for investors when assessing their allocations to the space.

Economy (I)

The global economy is gradually getting on a weaker footing; our business cycle monitor is flashing a global recession signal for the second consecutive month. Yet, a notable divergence is observable between manufacturing and services. Industry in advanced economies is on the verge of seeing its real activity contract. The leading US manufacturing ISM signaled contraction ahead in US manufacturing for the first time since June 2020. New orders are falling, inventories are building up, and therefore the cyclical outlook is deteriorating. Services are not budging, however, with the ISM non-manufacturing surprising to the upside at 56.5 in November. Also, (lagging) hard activity data on US goods consumption underscores the fact that the US consumer remains fairly resilient, with retail sales improving at a 1.3% clip in October. US non-farm payrolls well above 200,000 and accelerating wage growth also signal the labor market is still running hot.

In the Eurozone, leading indicators signal economic contraction for the fifth month in a row, though some signs of an easing in the downturn could be inferred from a composite Eurozone PMI that rose from 47.3 in October to 47.8 in November. The breadth of the slowdown has been increasing, however, with also the French services PMI – the last holdout among Eurozone countries – also slipping into contractionary territory in November. A Eurozone recession is imminent.

Markets anticipating a lower terminal rate and more significant rate cuts in November



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Economy (II)

Government support to households and corporates to weather the energy crisis amounts to EUR 600 billion for the Eurozone overall, with some member states spending close to 5% of domestic GDP. For the medium term, the fiscal impulse from further disbursements from the EUR 750 billion EU recovery fund is safeguarded, as the German constitutional court concluded there was no legal obstacle to German participation. However, the court was aloof with regard to the issue of joint EU debt.

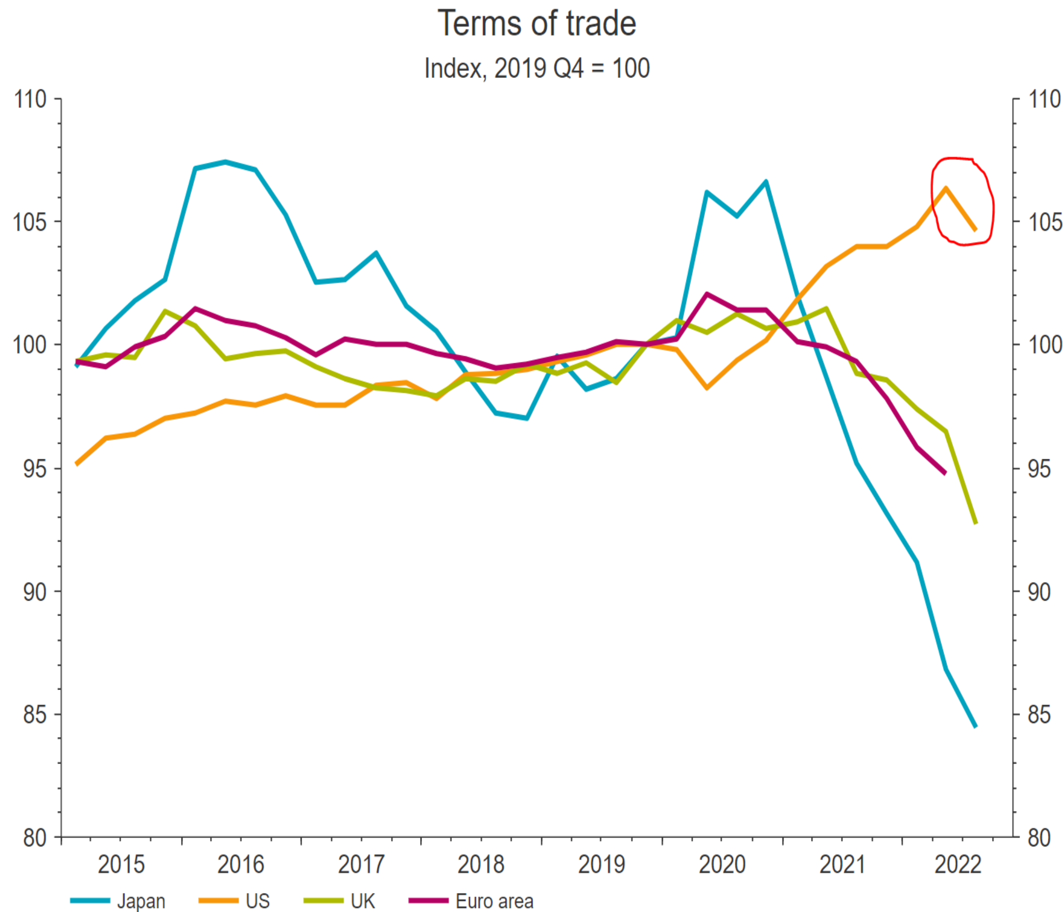
In China, recent policy pronouncements suggest an accelerated re-opening of the economy and a nuancing of the zero Covid policy. Some cities have removed the PCR test requirement for entering public transportation, while the WHO said the emergency phase of the pandemic is nearly over. November saw large liquidity injections by the PBOC to boost infrastructure spending. Also, the Chinese authorities issued a 16-point plan that will ease the malaise in the real estate sector, helped by mortgage rate cuts, lower required down payments and allowing banks to extend loans to the property developers.

US consumer is resilient, but for how long? The savings rate dropped to a decade low, consumer credit surged

All market data to 30 November unless mentioned otherwise

Economy (III)

Energy shock has benefitted the US dollar, but strength fading



Source: Refinitiv, Robeco

While inflation will stay top of mind into 2023, central bankers will start to show a higher sensitivity to decelerating real activity as the impact of the tightening cycle becomes more manifest in worsening macro data. The pace of rate hikes will slow as employment figures start to worsen. This will solidify the bull market for sovereign bonds and as such there will be better times ahead for the 60/40 portfolio following a dismal 2022. Yet, with core inflation still well above target in the first half of 2023, the peak in yields and the dollar might be further out, especially if the energy crisis lingers. Central bankers will likely stretch the pause after the hiking cycle and be reluctant to cut interest rates, even in the face of a US recession. While historically the Fed has started cutting rates in 80% of the cases when the ISM dropped below 50, and inflation remained above target in the subsequent quarter, the odds look lower this time around, with a more Volcker-like Fed that struggles to cool an overheated labor market.

Only in the second half of 2023 will the ball get rolling, in our view. Sahm's rule suggests that when this happens, the ball rolls fast. Once the unemployment rate rises by 0.5%, it ultimately moves up by at least 2%. When unemployment surges towards 5% (not unlikely given actual levels of leading US unemployment indicators, like the NAHB housing sentiment indicator), and disinflation accelerates on the back of a NBER recession in the second half of 2023, the Fed (and other central banks) will likely start cutting rates, albeit with a hawkish guidance.

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Important Information

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