



Fundamental Equities Outlook Q2 2021

Start searching for 'value with a future'

- We remain positive on global equities
- We expect the rotation from growth to value to continue – with a twist
- From deep value to 'value with a future'
- For a change, the upcoming earnings season will matter

We remain positive on global equities

With most major equity indices at or close to all-time highs, the tactical stance of any opinion writer who wants to sound smart and hedge her bets would be to point out all that could go wrong. Yet, with a global economy on the mend, driven by a surging US macroeconomy and central banks which – thus far – remain supportive, I will gladly take the risk of sounding less smart and state that our positive stance on global equity markets remains well underpinned. Of course, when everything looks good and expectations are high, a lot can disappoint, and I will point out some key hurdles ahead.

Undeniably, some parts of the world are still wrangling with Covid-19 and lockdowns, and sometime in the second quarter of 2021, the market is likely to start anticipating the dreaded t-word ('t' for 'tapering'). Moreover, Archegos Capital has reminded us how easy it can be even for a single-family office to create havoc in global equity markets. On the bright side, the world is learning to co-exist with a pandemic, the US has sprung on us a USD 1.9 trillion stimulus package, and the Biden administration is working on USD 2.3 trillion in infrastructure investments.

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For professional investors
April 2021

Robeco Fundamental Equity Team

While the fiscal bonanza will impact the US first, the rest of the world will also benefit from its repercussions for global activity. Let's not forget that the strong recovery expected in global trade is one of the reasons why the IMF has lifted its 2021 China GDP growth estimate to an impressive 8.4%.

Clearly, a sizzling economy means higher inflation, but we are still far from levels that would reverse the course of the economic recovery. We are, actually, in the sweet spot for equity markets, as these generally benefit from inflation rising from low levels: historically, the S&P 500 Index has shown outperformance most frequently when CPI was between 1% and 3%. The Robeco Macro Team estimates that headline CPI in the US will likely peak at 3.7% in May – driven by the higher energy price comparisons – but is likely to come down to 3% by year end, with core inflation around 2%.

We are also not concerned about the recent rise in yields. This was a consequence of higher inflation expectations, which in turn are driven by the strong economic outlook. In the end, real yields are what counts, and we are still comfortably in negative territory. Clearly, any trigger that would lead to a renewed rise in inflation expectations needs to be monitored. Even though central banks would prefer to keep real yields low, this is not fully in their control. Once the Fed starts discussing tapering, possibly later in the second quarter, this could trigger a further increase in real yields, at which point it will be up to the strength of the economic outlook to save the day.

The elephant in the room, from a recovery standpoint, is continental Europe, which is still in the midst of the third wave of Covid-19. Restrictions remain in place in most European countries and the risk is that these could get stricter, given that the pace of the vaccination roll-out remains disappointing. While this will undoubtedly delay the full reopening of the European economy, the underlying economic momentum has far from stalled. The manufacturing PMI of the Eurozone has now reached a remarkable 62.5 and the nonmanufacturing PMI has continued to improve, with the recent read only slightly below 50. Even the economic sentiment indicator of the European Commission came in at 100.9, a 13-month high.

Importantly, we expect that, by end of the second quarter, most of the vaccine supply constraints in Europe will fall away. By then, the European Union (EU) should have enough supplies to vaccinate close to 70% of its adult population. This means that, as long as European governments are able to execute on the vaccination effort, by end of Q3 we could make significant steps toward a reduction of the lockdowns. In the meantime, there is still sufficient fiscal stimulus in place, as well as abundant monetary support – as the recent monthly increase in APP & PEPP purchases by the ECB have shown.

From deep value to 'value with a future'

As the global economy continues to recover, we expect further rotation from the Covid-beneficiary and Covid-defensive stocks to those that will benefit from the economic normalization.

Many investors simplistically interpret this as a rotation from growth to value. There is more to this. To understand what lies ahead, we need to look below the surface. There are two aspects to what we have seen happening in equity markets over the last quarter.

First, value comes in different shades. We have witnessed the initial rotation phase from growth into value. This was a classic start of the reflation trade, where investors bought into the cheap laggards. This has meant that deep value stocks have outperformed the broader market. We saw this through most of the first quarter in developed markets (DM) and, since mid-February, in emerging markets (EM).

We believe that value has further outperformance ahead – as long as the economic outlook continues to improve. However, we expect an increased degree of selectivity among investors in their choice of value stocks. Investors will start to look for stocks that have the potential to deliver on their perceived value, showing better earnings potential in a normalization of the macroeconomic backdrop. Therefore, after the first wave of value investing boosted all cheap stocks, we expect the second wave to focus on what we call 'value with a future', i.e. companies with inexpensive valuations that do not discount their sustained earnings growth ahead. Given the polarization that we have seen in equity markets over the course of 2020, we still see attractively valued opportunities to choose from.

The result is that investors will start paying more attention to the sustainability of earnings going forward. This is likely to bring more prominence to issues such as the expected impact of high input costs on certain companies' earnings, following the acceleration in PPIs. The quality of balance sheets should also be under tighter scrutiny, since real yields are destined to rise further at some point.

Overall, we need to be aware that some companies whose stocks were bought as 'reopening' trades will be structurally weakened by the consequences of the lockdown, and are therefore unlikely to recover as the market may expect.

Indeed, we have already started seeing some signs of the change of guard within value in both DM and EM from the second half of March. Since then, value stocks with low expected price-to-earnings ratios have started to improve their performance compared to stocks with low price-to-book ratios.

Secondly, as we have also discussed in the past, 2020 was not only about growth, but also about extremely polarized market positioning. We call this the 'headline effect'. Stocks with a well-recognized brand or story saw unprecedented buying relative to the rest of the market. This may have been – at least in part – due to the more active retail participation in single-stock positions that we witnessed in 2020. The headline effect has been so extreme that the polarization between growth and value has not only been visible between sectors, but also within sectors. This has left active investors with what in our view is a significant opportunity to generate investment returns via individual stock selection.

As we reminded our clients last quarter, alongside all the well-known new energy and upcoming vehicle brands, and for all the high-profile digital giants, there are a number of companies that I like to call 'enablers'. These are part of the chain of products or services that support those big-name players, as well as companies that will be driven by those same trends. While their products are not as prominent or as glitzy, they will be growing in parallel. This is where much of the 'value' lies. Many of these stocks are still trading at reasonable valuations, although they are no longer as easy to find as at the end of 2020. We have already started seeing investors broadening their appetite for these stocks, as market returns across both DM and EM are now less concentrated. We believe this trend will continue.

For a change, the upcoming earnings season will matter

If investors do begin to pay more attention to how tenable company earnings are, the impending first quarter earnings season is likely to be a good starting point. The most interesting aspect of the last earnings season in the US and Europe was the muted price action. Both the US and Europe saw a negative skew to price action on the day of the results, meaning that stocks whose EPS beat expectations outperformed less than the misses underperformed. The market appeared to be sending a clear message that, for those companies delivering strong fourth quarter results, the strong results were already priced in, and that these companies were likely to become less of a focus as the economy reopened. As a result, we saw the rotation from the Covid-19 beneficiaries and Covid-19 defensives to the reopening hopefults. I believe the upcoming earnings season will set a different tone, and the market will pay more attention to the actual results.

We saw the market being driven by multiple expansion in 2020, which investors were willing to consider as the scarcity premium to buy into companies with positive earnings momentum. As economic growth picks up across the world, the market is likely to be less willing to pay such a scarcity premium, especially as the Covid-19 beneficiaries will be facing tougher comps from the second quarter onwards. At the same time, with the laggards-scooping frenzy of the first quarter, some reopening trades have run up significantly. Companies will have to live up to their increased valuations. Therefore, it is possible that we could see not only a pullback in expensive defensives that disappoint on guidance, but also in reopening trades that don't live up to expectations. Unlike the previous quarter, this earnings season will matter.

What could go wrong?

While we remain positive on global equities, there are a number of risks lurking in the background, that we need to be aware of and monitor.

The t-word. The next big hurdle that investors will have to digest is the start of tapering. We believe it's likely that the Fed will aim at completing tapering before the first rate rise. If we assume a first Fed rate hike in 2023 – which is what our Macro team expects – and the tapering process itself to last 9 to 12 months – based on the experience up to October 2014 – then we are looking at tapering to start sometime in the first half of 2022. Markets would not wait for the process to begin before starting to price it in. This means that we could see some anticipation later in the second quarter, and maybe as early as May, when the April FOMC minutes are released. Equity markets are likely to be less than enthusiastic about the t-word. Only proof that the economic momentum remains solid, and that tapering will be gradual enough not to disrupt it, would assuage them. So, it will all depend on how Covid-19 develops in terms of vaccinations, new strains and lockdowns. We don't see any reason to hit the panic button on global equity markets at this point, as we believe the economic recovery will continue and the Fed will be mindful of not spooking markets.

That said, equity markets may see an increase in volatility and we are likely to see selling pressure in some areas, including companies and countries with weak balance sheets. This could include the most fragile EMs, although the list is likely to be significantly shorter than in the taper tantrum of 2013. Most countries are in far better fiscal and monetary shape now than at that time. As long as global economic growth continues to improve and broaden, any volatility is likely to be short term and localized. Let's not forget that between mid-2004 to mid-2006, when the Fed hiked rates by 425 basis points, the S&P 500 Index saw a price increase of 12%, while the MSCI Emerging Markets Index rose 79% in US dollars. The key for equities, particularly in EM, is not what the Fed does, but the outlook for growth.

Higher taxes. An increase of the US corporate tax rate from the current 21% is also likely to cause ripples in the US equity market, as would a tax on earnings at the source for the large digital platforms. This will happen at some point, but timing and details are still unclear. Depending on the newsflow, we are likely to see occasional pressure on companies that would be hardest hit. More importantly, the US is not the only country that will look at replenishing the government coffers after unprecedented fiscal stimulus. The risk is that some countries may take fiscal consolidation steps too soon. The room for policy errors remains limited until the economic recovery becomes more broad-based.

Stronger US dollar. The greenback has paused its ascent for now. This has coincided with the retrenchment of US long-term yields. As long as the global economic recovery continues and broadens, the US dollar should remain relatively stable. It could weaken if investors increase their appetite for riskier assets, including non-US assets. However, should the differential in growth outlook between the US and the rest of the world widen further, the US currency could also reprise its ascent. In a lower growth scenario, EM is the region that could be affected the most, and we continue to look at the asset class on a market-by-market basis. Countries with higher inflationary pressure and less room – or will – for monetary tightening, such Turkey and Argentina, remain most at risk.

Implications for our portfolios

Both our DM and EM teams have remained positive on their respective equity markets. The only factor that we downgraded, from positive to neutral, is the sentiment factor in EM. We have seen unprecedented investment flows into EM of more than USD 120 billion since October 2020, and we expect inflows to continue but at a slower pace.

Our largest overweight across the Global and EM portfolios remains North Asia (China, Taiwan and South Korea), although we have taken some profit in China, where we expect market momentum to slow down. Firstly, credit growth in the country has peaked, and this is likely to lead earnings to peak later in the year. Secondly, around 40% of the weight of the MSCI China Index is in internet-related stocks. This affects the index in the rotation away from expensive and often loss-making digital stocks.

That said, the main change from a country standpoint in our Global Equity portfolios has occurred in DM, as we have added to US equities, moving to an overweight position, at the expense of Europe. The US is much further advanced in fighting the pandemic than the EU, and has significantly stepped up fiscal stimulus. Hence, we believe that a recovery in the US will be much stronger than in Europe for the foreseeable future, and that US equities will benefit.

Information Technology remains the largest sector overweight in our DM and EM portfolios and, within IT, we prefer hardware to the expensive internet-related names. We had already started to take profit in the high-flying Information Technology and Communication services sectors last year, and we continued earlier in the quarter, doing the same also in China and, to a lesser extent, Taiwan. Since last year, and earlier this year, we have added to the financials, consumer discretionary, materials and industrials sectors. Most importantly, and on the back of the polarization of returns that has been a legacy of 2020, we have often rotated positioning within the same sectors, reducing expensive names and adding to companies where we believed the positive earnings outlook had flown under the market's radar and was not yet discounted in valuations. We remain mindful of the importance of the quality profile of the companies that we invest in. Selection remains key, as not all companies will be able to recover from the effects of extended lockdowns.

To conclude, despite global equities having reached new highs and valuations being – on average – seemingly stretched, we remain positive on the asset class. As we have said before, the problem with averages is that they are averages. We continue to believe that current valuation levels will not put a damper on global equities upside. They will, however, determine where we find more opportunities. Firstly, not all markets are richly valued, and certainly not all stocks. The exceptional polarization that we have seen in stock performances over 2020 still allows active investors to find attractive stocks at more reasonable valuations. Secondly, we don't expect global multiples to expand further. Instead, earnings upside will drive the market forward. Start searching for 'value with a future'.

I wish you an enjoyable and, hopefully, valuable read. Please feel free to reach out to us with any comments or questions you may have.

Fabiana Fedeli
Global Head of Fundamental Equities

Table of contents

Developed Markets Equities All systems go	7
Emerging Markets Equities Large-scale vaccination programs should lead to re-opening.....	10

Developed Markets Equities | All systems go

- Vaccinations are gathering pace in the US, Europe lags
- Global economic growth expectations revised upward
- Fed and ECB to remain on hold until the recovery is assured

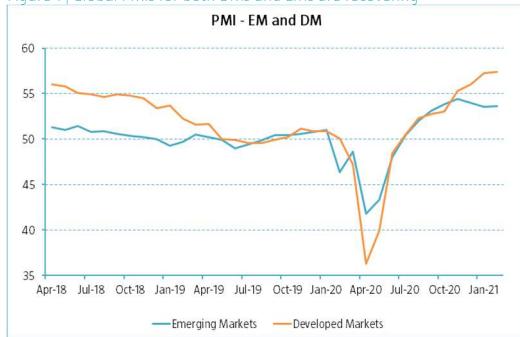
Five-factor summary

Factors	Score
Macro	+
Earnings	+
Valuation	=
Technical	+
Sentiment	=
Total	+

Source: Robeco Global Equities Team

We maintain a positive outlook for developed markets (DM) equities. The macroeconomic environment continues to be very supportive for equities. Global economic growth forecasts are being revised upwards, while interest rates and inflation expectations should continue to normalize. As long as interest rates and inflation do not overshoot, we expect the environment to remain benign for equity markets. Positive global earnings revisions also remain very supportive, especially when we compare the worst quarters of last year, where we saw the full impact of the Covid-19 pandemic in both Q2 and Q3 of 2020. While DM equities are not cheap, we also think that the rotation that we have seen this year from expensive growth names to cyclical value names will continue. The valuation of the market is just an average and it does not tell the full story. Some pockets of the market remain cheap while large cap growth stocks names are still too expensive. Technical analysis remains supportive for the overall market, given that the value rotation suggests a broadening of the recovery. Last year, the overall market was pushed higher, driven primarily by the Information Technology and Communication Services sectors. Currently, we see a growing participation from the more cyclical sectors, too.

Figure 1 | Global PMIs for both DMs and Ems are recovering



Source: IBES, MSCI, March 2021

All systems go

So far this year, we have seen DM equities rise by about 9% in euro terms. Still, it doesn't feel that way, as the most visible large cap growth names have lagged the market, while cyclical names in Energy, Materials, Industrials and Financials have rallied strongly. We think the current 'goldilocks' environment for DM equities will prevail for some time, as the global economy is only starting to recover. Currently, consensus expectations point to global GDP growth of 5-6%, with emerging economies growing slightly faster than developed ones. That said, economic growth in DM is still expected to reach about 5% in 2021. With the recovery, interest rates have started to rise, inflation expectations are picking up and yield curves have begun to steepen. At the same time, central banks appear to be willing to hold off for now, as they want to see evidence of a sustained recovery before winding down their support. Therefore, 2021 is likely to be another good year for DM equities.

Figure 2 | Economic growth estimates for 2021 for both EM and DM



Source: IBES, MSCI, March 2021

More fiscal stimulus is coming in the US

US president Joe Biden managed to get a substantial additional stimulus package of about USD 1.8 trillion approved. This comes on top of earlier fiscal stimulus packages and will have a significant impact on overall US economic growth, both this year and next. Current consensus expects 6% US GDP growth this year, and around 5% next year. In addition, Biden has indicated that the US will continue to ramp up vaccinations to help the US economy return to normal as quickly as possible. The target is to reach 200 million vaccinations by the end of April. The US is much further advanced in fighting the pandemic than the European Union (EU), which seems incapable of getting its act together. As a consequence, we have adjusted our portfolio positioning by adding to US equities and moving to an overweight position in North America, at the expense of our position in Europe. We think that a recovery in the US will be much stronger than in Europe.

and that US equities will benefit. We see much more opportunity for US long rates to rise, causing a steepening yield curve, as the Fed will control the short end of the curve. This should help US Financials, in particular domestic banks. At the same time, rising long rates are a problem for high-duration growth stocks in Information Technology and Communication Services. For this reason, we have added to US Financials and have lowered our overall weight in US Information Technology and Communication Services.

Europe starting to see the third Covid-19 wave

Compared with the US, the economic recovery in Europe appears to be more moderate. Most European economies remain paralyzed by lockdowns, as a third Covid-19 wave approaches. As a consequence, economic growth expectations for the EU for 2021 are far more modest than for the rest of the world. To give an example, Germany, which is probably amongst the stronger European economies, is expected to rebound to about 3% GDP growth in 2021. For now, from a top-down perspective, we strongly prefer other regions with more dynamic growth opportunities than Europe.

Japanese economy will start to recover as well

We do think the Japanese economy is poised to recover as well. Current consensus GDP forecasts expect 2-3% GDP growth for Japan in 2021. The turnaround of the global economy will show the operational leverage in Japanese earnings. Some improvement is already visible in recent results, but it will accelerate in the new fiscal year from the end of March 2021. The remarkable weakness in the yen will give another bump to earnings. Relative performance has picked up and we expect foreign investors to move more decisively to the buy side. Equity also looks more appealing to locals, as bond yields remain super low. Valuations remain attractive but investors need to monitor the progress of companies to act in the interest of shareholders and focus on higher ROE. One striking point is that economies in Asia-Pacific in general have been far less affected by the Covid-19 outbreak. It also seems like most large countries in the region have dealt with the virus in a relatively efficient way, and that the damage to their economies has been far less than in Europe, for instance. In the global portfolios, we maintain an underweight position in Japanese equities in favor of Emerging Asia. That said, we prefer Japan to other Developed Asia equity markets in our Asia Pacific portfolios.

Earnings revisions for the MSCI World Index continue to rebound

Earnings revisions for the MSCI World Index have clearly rebounded and look very strong. This should support equity

markets further. We also like the fact that earnings revisions are improving in most sectors and that the earnings recovery is relatively broad based. Year-on-year comparisons will continue to ease into the summer, as Q2 and Q3 of 2020 were the quarters in which the global economy was most affected by the Covid-19 pandemic.

Figure 3 | Earnings revisions for the MSCI World continue to recover



Source: IBES, Robeco, March 2021

Valuations remain high from an absolute perspective

Equity valuations around the world still indicate that, compared to equities, there are very few attractive yield assets available. The MSCI World Index has an average forward price-to-earnings ratio of 21 times. It will be interesting to see what happens to valuation multiples with rising rates and the current strong rebound in earnings. With rates rising, there is less scope for multiples to rerate higher. In our opinion, earnings upside will have to become the main driver of equity markets going forward.

Figure 4 | Absolute valuations are high in developed equity markets



Source: MSCI, Robeco, March 2021

The main risks to our outlook

Our outlook for DM equities is quite bullish. The main risks to our outlook are related to new variants of the Covid-19 virus and potential new outbreaks, or a disappointing pace of global vaccinations. We do think that the current rotation in the market towards more cyclical value stocks will continue at the expense of high-valued growth names.

Implications for portfolio positioning

In the **Global Equity portfolios**, we have moved to a slight underweight position in European equities and an overweight position in North America. We also maintain an

overweight position in Emerging Asia and are underweight in Japan. We continue to look for companies with a good or improving sustainability profile, that also have a good long-term ROIC track record and a decent valuation on free cash flow. We took some profit over the past quarter in the high-flying Information Technology and Communication services sectors, and have added to the Financials, Consumer Discretionary, Materials and Industrials sectors, to broaden the portfolio and reduce exposure to high-duration growth stocks.

Regarding our **Asia-Pacific portfolios**, the outlook for the region remains promising. We monitor high and rising earnings growth expectations as risk for potential disappointment. We prefer Japan and South Korea in the region.

Japan has been able to maintain its neutral status in the US-China trade war and thus can still easily do business with both sides. This is relevant for its tech hardware and capital goods leaders. With large cyclical exposure, Japanese leading corporations have gone through three tough years in terms of earnings performance. The rapid shift from growth to value is likely to continue in a cyclical upturn, and our portfolios are well positioned for that.

In Australia, high commodity prices and high home prices support the economy. The local currency is thus likely to stay strong. Banks have quickly moved back to lofty valuations. With little else to appeal, we remain underweight. The global rotation towards value has generally been much more modest in Asia than in other markets, and really only started in February. Chinese investors continued to buy into fast-growth stories until then, but a reappraisal has started there too. We expect the value trade to catch up further in the second quarter. After the first wave boosted all value stocks, we expect the second wave to focus on 'value with a future', ie value companies with sustainable earnings growth ahead. Given the polarization that we have seen in equity markets over the course of 2020, there are still attractively valued opportunities to choose from.

Hong Kong and Singapore markets remain dependent on re-openings and, with many Asian countries seeing very low case counts, we can expect some relief. However, we find little appeal in individual stocks. Our main overweight position is in South Korea, where we now must monitor what the long-overdue lifting of the short-sale ban in May will do to retail sentiment, which has driven stocks to historically lofty multiples. In absolute terms, South Korea remains cheap with very high earnings growth expectations.

Across Asia Pacific, we hold relatively large positions in Information Technology and Materials because we see strong evidence of pricing power there.

Emerging Markets Equities | Large-scale vaccination programs should lead to re-opening

- Vaccinations will help EM re-open in Q2
- Key developments to watch in Q2 2021:
 - Later than expected, the EM worlds should reopen
 - Rising US bond yields mean EM may outperform DM
 - Earnings across EM will grow even faster than in Q1

Five-factor summary

Factors	Score
Macro	=
Earnings	+
Valuation	+
Technical	=
Sentiment	= (downgrade from positive)
Total	+

Source: Robeco Emerging Markets Team

We maintain our constructive stance on emerging markets (EM)DM. As the table above shows, our earnings and valuation factors remain positive, while our sentiment factor has been downgraded from positive to neutral, after unprecedented consecutive inflows since October 2020. We have kept the technical factor neutral, given that developed and emerging markets have risen roughly at the same pace on a year-on-year basis. From March 2021, emerging equity markets returned 47.8% in euros versus 43.8% for developed markets.

Earnings revisions in emerging markets are in line with those in developed markets. The earnings revision ratio for EM has improved rapidly, and has already reached a 10-year high. In addition, earnings per share (EPS) are expected to grow by 29% on average in EM in 2021, versus 'only' 19% in DM. We therefore remain positive on the earnings growth for EM.

We downgraded the sentiment factor from positive to neutral, since we have seen unprecedented investment flows into EM of more than USD 120 billion since October 2020. We expect inflows to continue, but at a slower pace than in the last two quarters. That said, the constructive sentiment should persist, since investors are increasingly looking for value propositions that will benefit from a reopening of the global economy.

China's leading position in EM macro

The Chinese economy is on an expansion track, after successful control of Covid-19. The strength of the economy is demonstrated by rising PPI and PMI indicators. China is also accelerating its vaccination campaign, aiming for a 40% vaccination rate by July, following a slow start. We expect economic policy normalization to continue and credit growth to slow again, after a strong start in 2021, especially as economic activities resume recovery in Q2.

Vaccination rollout and subsequent economic recovery in DM, led by the US, will also support China's export momentum. External risks, such as rising inflation expectations and the re-escalation of tensions between China versus the US and its allies remain significant. Furthermore, the PBoC will start winding down monetary stimulus this year. Having said that, the stimulus reduction will be very gradual to ensure stability.

The early March National People's Congress (NPC) set a rather conservative GDP growth target for 2021 of 6% with flexibility, and focused on longer-term goals, such as doubling the size of the economy by 2035. More important than the actual GDP target are other measures such as the debt level, carbon emissions and poverty reduction. A domestic credit tightening cycle, combined with the US recovery, could lead to inflationary concerns, which could compress valuation multiples.

Next to China, two other North Asian nations have excelled in terms of their handling of the pandemic and their economies: Taiwan and South Korea. Taiwan continued to outperform MSCI EM in the first quarter of 2021, after a very strong 2020. China and South Korea – also strong outperformers in 2020 – lagged the average slightly in Q1 2021. Having said that, the outlook for all three countries remains positive versus the EM average, owing to their strong macroeconomic outlook and policies.

India and Southeast Asia continue to suffer severe Covid-19-related lockdowns. South Asian markets have been far less buoyant than their North Asian counterparts. Indian equities achieved a small positive return in the first quarter of 2021, but most Asean equity markets continue to disappoint and lagged the average return.

In Latin America and EMEA, most equity markets recovered from a dreadful 2020. Exceptions to this have been Brazil and Turkey, where political interference has led to a substantial underperformance for equity markets so far this year. In Brazil, president Bolsonaro replaced the CEO of Petrobras. Turkey's president Erdogan did the same with his central bank governor. Political interference seems to be a structural shortcoming in both countries, which is the

most important reason for our cautious stance towards their equity markets.

Inflation environment still benign

Inflation has been moving higher across some emerging countries. The pass-through from the currency depreciations in 2020, rebounding commodity prices and disruptions in supply chains explain this development. Very large liquidity injections and the adoption of unconventional stimulus measures are potentially inflationary in nature. Still, we expect inflation in 2021 to be roughly 2% in both emerging and developed markets, relatively stable on a year-on-year basis in EM and on the rise in DM, as illustrated in Figure 5.

Figure 5 | Inflation estimates



Source: MSCI, Robeco, March 2021

Monetary tightening in some EM countries

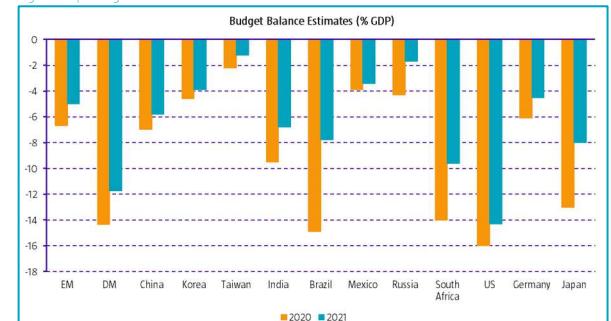
Despite a benign inflationary environment, monetary policy stances are starting to diverge across emerging countries. The recent rise in US rates has added to the hawkish tilt of some EM central banks, particularly for the high-yielding economies. While we do not forecast broad-based monetary tightening across EM, Latin America is expected to lead the pack for the remainder of 2021, together with Turkey. Brazil is likely to hike rates further, with its central bank expected to react more aggressively to tighter global financial conditions and uncertainty over

the fiscal developments. Brazil has already increased interest rates from 2% to 2.75% in March 2021. Russia raised interest rates by 25 basis points (bps) in March 2021, and the now ex-governor of Turkey's central bank impressed foreign investors by hiking interest rates by 300 bps since the beginning of 2021. Meanwhile, other central banks in the large emerging countries are keeping rates steady at the current low levels. It remains to be seen how hawkish they may eventually become in light of a relatively dovish US Federal Reserve.

Conclusion: we keep our bullish stance on North Asia

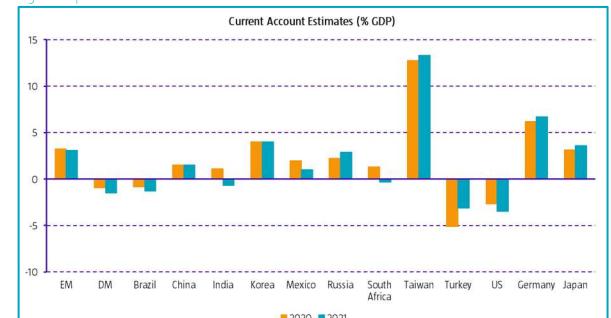
We keep a constructive view on EM macroeconomics in general, and for North Asia in particular. This region could see GDP growth numbers in the low single digits in 2021, with large current account surpluses and relatively low fiscal deficits. Meanwhile, South Asia and most of Latin America and EMEA could see high single-digit GDP growth, resilient current account balances and fiscal deficits close to all-time highs. Fiscal and current account balances are likely to improve substantially as economies recover, though. Figures 6 and 7 illustrate this backdrop.

Figure 6 | Budget balance estimates



Source: Bloomberg, Robeco, March 2021

Figure 7 | Current account estimates



Source: Bloomberg, Robeco, March 2021

On average, the current account balances of emerging countries continue to look much better than those of their developed counterparts. The same is true for fiscal balances.

Continued recovery in earnings expectations

The earnings revisions ratio for emerging markets reached an all-time low in every region and every sector in the second quarter of 2020, but bounced back swiftly and strongly, reaching decade-high levels, as Figure 8 and 9 show.

Figure 8 | Earnings revisions EM



Source: IBES, Robeco, March 2021

Figure 9 | Trends in earnings expectations EM



Source: BofA

In March, the one-month earnings revisions ratio for EM dropped from 1.33 to 1.19, as shown in Figure 9. From a longer-term perspective, this ratio is still close to its highest level in ten years.

Earnings revisions in EM have come down since our last quarterly, but are in line with those in DM. Also, with the much-stronger earnings growth expected in 2021 for EM (+29%) versus DM (+19%), we remain upbeat on the earnings factor.

Figure 10 | Earnings revisions MSCI World Index



Source: IBES, Robeco, March 2021

Valuation a positive factor for emerging markets

Valuation remains a positive factor for EM in the near term. The 12-month forward P/E ratio approached a 10-year low in March 2020, but bounced back to much higher levels, as Figure 11 shows.

Figure 11 | EM valuation remains attractive



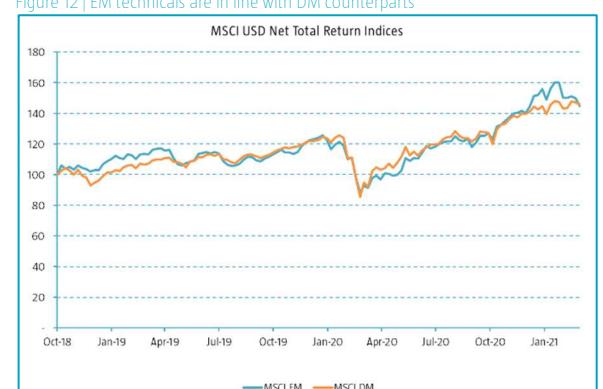
Source: MSCI, Robeco, March 2021

The average P/E ratio in emerging markets remains close to 15 times, compared to 21 times for MSCI World Index. This translates into a 30% valuation discount for EM relative to DM. The average historical discount is close to 20%. From a price-to-book perspective (P/BV), EM are trading at a 30% discount relative to DM. The average historical discount is about 15%.

Technical picture neutral

Emerging equity markets have been performing roughly in line with their developed counterparts over the last 12 months. EM slightly outperformed DM, therefore our technical factor remains neutral for now.

Figure 12 | EM technicals are in line with DM counterparts



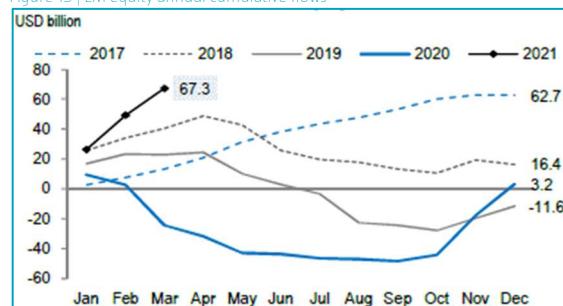
Source: MSCI, Robeco, March 2021

Sentiment downgraded to neutral

We have downgraded the sentiment factor from positive to neutral, following the more than USD 120 billion of cumulative inflows into emerging equity markets funds seen over the last two quarters. Inflows are expected to continue, albeit at a slower pace, as investors look for

attractively-valued asset classes with high yields. In an era of reopening economies and large-scale vaccination campaigns across the globe, global investors' risk appetite might increase a bit further. Simultaneously, investors might seek more value for their portfolios.

Figure 13 | EM equity annual cumulative flows



Source: EPFR Global, March 2021

Implications for portfolio positioning

We maintain the value tilt in our **Emerging Markets Equity portfolios**, which have a lower average P/E ratio than the MSCI Emerging Markets Index. We still have an underweight position in those countries that we believe will be amongst the last ones to fully reopen. Meanwhile, we have an overweight position in countries that have been least affected by the pandemic, namely North Asia (China, Taiwan and South Korea). During the last quarter, we increased the portfolio weights in South Korea and the current portfolio is close to maximum overweight in that market. Although we took some profits in expensive outperforming stocks in China and Taiwan, we have maintained our overweight position in Taiwan. Within the rest of EM, we slightly increased our positions in Brazil and India, as we believe valuations in these two markets now reflect the full impact of the lockdowns on both the real economy and corporate profits. In Brazil, we have a larger weight on exporters compared to the domestic economy given a slower than expected macro recovery and the increased political interference mentioned earlier. In India, equities are now priced for perfection, after robust domestic and foreign investment flows. So far, it seems earnings are coming through strongly, but we struggle to find good investment ideas with upside. We have a slight overweight position.

From a sector perspective, we keep a comfortable overweight position in Consumer Discretionary and Information Technology. Meanwhile, we keep an underweight position in the expensive Consumer Staples sector. We also continue to have an overweight position in Financials, since valuations have corrected the most in this sector following lockdowns and in some countries the credit profile is better than initially expected.

In general, we remain confident in Chinese equities, while being cautious on external geopolitical risks. After the March correction, valuation became attractive on a relative basis, especially for A shares, which have come down to the historical average level. Earnings revisions show positive signs of stabilizing and moving into an upward trend. The continuing rise in PPI will also be positive for manufacturing profits. Therefore, we expect the Chinese market to be volatile but constructive in the second quarter of 2021. Generally speaking, we are positioning our portfolios towards more value, by taking some profits on stocks with stretched valuations. We also focus on earnings upside momentum for our portfolio construction.

In our **Chinese Equities portfolios**, we reduced our IT exposure to an underweight position, and reduced our overweight position in consumer discretionary to a neutral weight. We added to Energy and Financials on earnings recovery potential, but remain underweight. We continue to add to Utilities on improving earnings outlook. We also reduced exposure to Industrials on the back of peaking credit growth in China. Our positioning remains largely unchanged for other sectors, such as our overweight position in Materials, and the neutral weight in consumer staples and telecommunications. Within each sector, though, we have reduced expensive names and added to companies with strong near-term growth visibility.

The **Chinese A shares equities portfolio** has kept an overweight position in Consumer Discretionary, Materials and Industrials, which are mainly driven by domestic demand and global recovery. We increased our underweight in Consumer Staples by selling some high-valuation names, and have reduced our underweight in Financials by adding to quality banks, as these tend to feature attractive valuations and earnings upside.

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