ROBECO
The Investment Engineers

Global Fixed Income Macro Outlook

The Covid shock and the Baa recovery

- Fixed income opportunities shifting swiftly from AAA Governments to credit…
- …although we recommend careful selection, with particular caution in EM
- Traditional frameworks for economic recoveries may not work. We suggest an alternative

Macroeconomic and policy outlook

After the shock

While Western economies are only just beginning to show the first signs of the scale of the Covid-19 economic shock, markets want to anticipate recovery. Certainly, we expect a strategic multi-year opportunity in higher quality credit, Baa or otherwise. But on the growth outlook, we are skeptical of some of the assumed trajectories.

Western market participants often have a fixed set of scenarios for future growth, parameterized by letters of the alphabet, including V, U, W or L-shaped. But, not only is this an investment-writing cliché, we think it is also a false choice for Covid-19.

Just because our Western alphabet has been around since Etruscan times does not make its letters the best economic guide. Vs and Ws, with their sharp bounces, and mean-reversion assumptions seem to belong to a 1945-2007 world, as laid out by Bordo and Haubrich, or Zarnowitz, a prior era compared to post-2008 structural

Outlook
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Robeco Global Macro Team

trends. U seems to ignore ten years of lower growth and rates. The letter L seems more suited for Japan.

Turning Arabic – a Baa-shaped trajectory

Covid-19 poses new market and economic questions: we have the competing theories and scenarios of epidemiologists, the second derivative of new infections and the flattening of curves (infection curves, not US Treasuries or credit maturity curves).

> ‘In an age of lower secular growth trends, low rates, older demographics and higher debt, the elongated horizontal sweeps of the Arabic alphabet seem a better fit than western equivalents’

We think 2020-21 growth trajectories are better described by the Arabic letter ‘Baa’’, in its final form (Figure 1). In an age of lower secular growth trends, low rates, older demographics and higher debt, the elongated horizontal sweeps of the Arabic alphabet seem a better fit than western equivalents.

Figure 1 | The Arabic letter Baa’, in the final form

Source: Public domain, Robeco

The 5 stages of growth (and grief)

Think of the letter Baa’ depicting five stages of growth in 2020-1:

1. The sharp downward shock. Get ready for retail spending, labor market data and industrial production to follow the initial read from jobless claims and PMIs.

2. Weakness along the bottom during any ongoing lockdowns. If travel and sporting events for example, are not back on until, say, August, then by deep into Q3 we will have activity far below 2019 levels.

3. Eventually, as businesses, cafes and bars re-open (we hope), we expect a sharp bounce back, a path equity markets keep trying to price in and asset managers with their vested interests overly emphasize. For those using the Roman alphabet V or U, the story stops here. But we think there’s more to it.

4. We see a high risk of a second downleg for growth, for three reasons:
   a. Emerging market (EM) crises following the economic shock of H1 2020, as the most vulnerable countries face political and sovereign crisis.
   b. Second-round effects on business investment resulting from the huge hit to companies’ financial health (especially of SMEs).
   c. Healthcare experts warn of a potential second wave of infections, possibly with mutations, when the northern hemisphere winter of 2020/21 begins.

5. Low long-term trend growth, with many pre-GFC and indeed pre-Covid-19 trends structurally changed for good.

So we expect a recovery in Baa-rated credit. But for economic trajectories, we expect Baa’. It’s time to leave V and W to German carmakers, U to lavatory plumbing and L to new car drivers.

Q2 economic collapse, and a GFC-style GDP base case

We previously noted the late-cycle risks to the economy and markets. All that was needed was a shock. And with Covid-19 we’ve certainly had that. To both supply and demand. We consider three scenarios, in part inspired by a 2006 study used by the World Bank.[1]

Our *base case* envisages the viral outbreak peaking in Europe and the US over the next 4-6 weeks, and slowing thereafter – following the Chinese pattern. Lockdowns should eventually ease and business activity should resume from depressed Q2 levels. In line with Arabic calligraphy, we do not expect a straight line, and expect a second wave of infections in the autumn. We assume that countries will be less inclined to opt for a full lockdown during a second wave of infections, if intensive care capacities have been ramped up and mortality rates decline. Yet some of the direct economic effects of the

[1] https://cama.crawford.anu.edu.au/pdf/working-papers/2006/262006.pdf. See also a March 2020 study by Warwick McKibbin and Roshen Fernando, https://www.brookings.edu/wp-content/uploads/2020/03/20200302_COVID19.pdf

virus on discretionary spending (impediments to travel, eat out, etc.) may persist, and there are negative circularities in employment and business capex, for instance. It's been so long since the last recession, some forecasters may have forgotten that these dynamics play out reflexively.

'Many things we take for granted will change. *V*s, *U*s and *W*s seem to completely miss the potential for such structural changes'

Many things we take for granted will change. The combination of Greta Thunberg and coronavirus on the one hand on air travel, or with the oil price war on hydrocarbons on the other, seem a force to be reckoned with. Pity the airline or oil executive. Vs, Us and Ws seem to completely miss the potential for such structural changes.

The consensus expects -16% (QoQ, annualized) US GDP growth for Q2, and -1.5% for 2020. The Euro Area Q2 numbers are similar, with full year 2020 at -3.5% (based on a selection of recent broker forecasts). We suspect the downgrades to growth, earnings and sovereign and corporate credit ratings aren't over. All in, our base case sees 2020 real GDP in the US and the Eurozone at least matching the FY 2009 economic contractions of respectively circa -3% and -4.5%.

Given the massive fiscal easing, we expect government budget deficits of at least 8-12% of GDP. This is necessary in the short term. Yet further out, it proffers higher sovereign debt burdens and fiscal drag. Many economies (the UK and Spain, for instance) just spent the last decade gradually paying off the government debts of the previous crisis. There is also the relationship between high debt and scarce growth – consider Italy and Japan. In some countries, fiscal intervention may also mean a higher government role in the private sector, especially in Europe. Following Adam Smith or Schumpeter, if too many scarcely viable companies are kept alive by the economic ventilator of government emergency financing, then resources will not be effectively redeployed in the real economy. Without a sharp rise in defaults and unemployment, we should expect lower trend growth in future. There seem to be policy dilemmas everywhere.

A more *negative* scenario assumes more than one additional wave of infections and lockdown over the next 9 months or so. Business activity across DMs only recovers meaningfully from end-2020, implying FY 2020 real GDP contractions of circa 10% or more in the US and Eurozone. Fiscal deficits, in turn, would end up far above 12% of GDP.

A more *positive* scenario, with a much smaller impact of future outbreaks aided by breakthroughs in treatments or vaccines, could see a recovery from a Q2 trough, leading to FY 2020 real GDP contractions that are milder than the GFC. Fiscal deficits, nonetheless, end up above 5% of GDP.

We view the risks as skewed to the downside.

Inflation: Supply shock may not mean price shock

Despite volatility elsewhere, inflation may be surprisingly dull. In the earlier-mentioned study on the economic consequences of pandemics, McKibbin and Sidorenko suggested that inflation in the US and Germany could rise by respectively 2.2 and 2.6% in a "severe scenario". On the supply side, we do indeed see scarcity of healthcare services and some goods, and assume some prices will rise. However, so far we have not seen a large disruption of port activity that could lead to a broader scarcity in goods. Nowcast inflation data from the Cleveland Fed also shows no material change in inflation so far.

Demand shocks on their own are of course highly deflationary. The recent decline in the oil price is likely to reduce US inflation by approximately 0.7%. But, there are clearly also longer-term inflationary consequences from the current crisis. The fierce monetary and fiscal impulses are one, but another may come from further de-globalization. The virus shock has exposed vulnerabilities in international supply chains which were already under scrutiny well before the outbreak. Evaluating these vulnerabilities will probably lead to shifts in production away from the most price-efficient areas. To be continued.

The policy response: central banks lock down curves

After the Bank of Canada's 27 March rate cut, all G10 central banks have now set rates at 0.25% or lower. For now, we don't expect many other G10 central banks to join the ranks of the BoJ, ECB, DNB and SNB in adopting negative rates. The remaining room to cut rates materially sits at the PBoC still and elsewhere in EM.

For the first time since the GFC, central banks have had to focus on ensuring the financial system is functioning properly. The Fed briefly lost control of the Treasury curve, as did the ECB the BTP curve in mid-March. This does not happen often! Illiquidity premia have come back from their most extreme levels: see the spread between On the Run and Off the Run Treasuries, MBS spreads and Treasury asset swaps. With over USD 630bn in Treasury purchases under QE4 in its first two weeks since mid-March, the Fed are not messing around. The US stimulus bill gives the Fed enough collateral to launch USD 4trn in lending or corporate bond buying programs (the SMCCF and PMCCF – the Primary and Secondary Market Corporate Credit Facilities).

'Central bank lockdown effectively provides social distancing between DMOs and the bond vigilantes'

The ECB could possibly activate the OMT (Outright Monetary Transactions) program, in case the launch of EUR 750bn in Pandemic Emergency Bond Purchases (PEPP) proves insufficient. We expect asset purchases from the existing asset purchase program (APP) and PEPP to top EUR 1tn in 2020. The softening of TLTRO (targeted longer-term refinancing operations) terms could add a further huge liquidity injection via the banking system. This could be directed towards sovereign bonds, as in the past. This should for now stave off a return to 2011-style Eurozone sovereign crisis. Getting northern and southern viewpoints to converge remains as big a challenge as ever, as illustrated by the recent European Heads of State meeting. Joint issuance, in the form of a so-called Corona bond, is probably a step too far too, despite dreams in Brussels.

Globally, forward guidance would be a straightforward next step. Fed staff research, and prior Fed and ECB experience would support it.

Fed officials such as Governor Lael Brainard have floated the idea of yield curve control, a policy the Reserve Bank of Australia has now adopted. A credible cap could also limit the amount of bond purchases needed to stabilize yields, potentially up to the 10-year point – as per BoJ practice. We expect more on this topic.

The bottom line across policies is the new central bank mission to lock down rates curves. This is essential, given the huge increase in government bond issuance to come. We expect significantly higher T-bill issuance, being termed out later on. This process requires the central bank counterweight to prevent sharp bear steepening of the curve. Central bank lockdown effectively provides social distancing between DMOs and the bond vigilantes. It may also provide social distancing versus profits for life insurers, solvency for pension funds and income for retirees, but that is a story for another day.

Rates Strategy

We view government bonds as a range trade. We think the big downward fall in yields is largely done. Our preferred starting point for the valuation of government bonds is our view on central bank rates two years from now. We see zero hikes for the Fed and possibly 10bps in cuts by the ECB over this two-year horizon. We expect 10-year yields to trade in the same narrow ranges around these official rates estimates as they have done in the past five years. For the coming months, this exercise gives an expected range of 0.5 to 1.2% for 10-year US Treasuries, and a narrower range of -0.2 to -0.6% for Bunds. We do expect modest curve steepening further out, especially in 10+ maturities, given probable issuance requirements as well as reflationary central bank policy.

So we see a good old-fashioned L-shape for official rates at least. But this is not new. Rates stayed at the effective lower bound (ELB) in 2009-2015 despite frequent attempts – every year – by market participants to try to price in hikes. On the flipside, we don't expect negative-rates policies to be exported that much further beyond their current jurisdictions.

With expectations for front-end rates two years out capped and yield curves controlled, we are skeptical of the view that yields are set to rise inexorably. Since 2009, the market has structurally over-estimated the R*, the peak rate for the cycle, and a whole host of structural economic and debt-based factors. Should front-end markets again try to price in hikes too quickly, we expect tactical opportunities to get long.

Having had outright durations of over 8 years in Global Aggregate (which is over 1 year above benchmarks) in February and most of March 2020, we have taken profits on duration in US 2 years, US 10 years, Australia, New Zealand and Japan, amongst others. We see residual further duration opportunity in selected Asian market front ends. We expect a range trade from here, with a bias to steepening in due course.

The volatility has thrown up spectacular cross-market opportunities (Treasuries versus Gilts, and JGBs versus Bunds being two that we have profited from). Should volatility continue, we expect more such opportunities.

Fixed income sector allocation

We think the best allocation opportunities are now gradually to build longs in IG credit (accumulating positions when the OAS is in the 300-600 area), and in

BB high yield (accumulating when the HY OAS is >1000). We are cautious on EM hard and local currency, and view EM FX mainly as a risk hedge against credit longs. EM flows remain a risk and there are the second-order effects mentioned above. The potential for rolling crises means there are plenty of parts of the EM universe to avoid. For Aggregate portfolios, our valuation frameworks suggest there is little volatility-adjusted value in Spanish and Italian debt, compared to IG credit. But for government-only portfolios, we see opportunities versus core rates.

'For fixed income asset allocation, we think the best opportunities are now gradually to build longs in IG credit and in BB high yield'

The key opportunity in credit

For all of Q2-Q4 2019, we saw very little opportunity in credit. It is hard – but crucial – to be disciplined and patient when spreads are tight and when both valuations and fundamentals are late cycle, regardless of short-term incentives of chasing carry. We came into the Covid-19 volatility with an overweight in EUR IG versus underweight in USD IG, and betas just >1, while in HY, we had 0% net exposure. This sets us up with fire power for the current opportunity.

Compelling arguments for bulls…

What a change March 2020 has brought. We are now at credit spread levels seen only for the third time since the 1930s: in the early 1980s, 2008 and now 2020, using Federal Reserve and ICE BofAML data. Policymakers have stepped in with the Fed breaking new ground by joining the ECB and Bank of England, in buying corporate bonds via the PMCCF and SMCCF.

The bull case is that IG spreads over Treasuries have peaked at +400bps and HY at just under +1100bps. For the ECB there is the PEPP and increased CSPP (Corporate Sector Purchase Program) purchases. For credit, the best part of the huge fiscal policies mentioned are de facto bridge financing for eligible companies. The scale of fiscal commitments already announced took two years to achieve in 2007-09, culminating in the April 2009 G20 meeting and the birth of the new credit bull market. Illiquidity premia in US Treasuries and MBS spreads may now have peaked, giving hope for higher-quality credit.

…but also for bears

We are not complacent and are preserving some firepower for much wider spread levels, should markets deteriorate. We view 2008 valuations as fully plausible in downside scenarios. Many market participants seem to dismiss this, having apparently become overnight experts in epidemiology. Many bullish views on credit currently seem commercially motivated. It is well documented that a lack of detachment can create blind spots. Going back to first principles, credit spreads must provide compensation for default risk, downgrade risk (in IG) and illiquidity premia. In a deep recession all these contributions to the headline credit spread of course widen substantially. The depth and length of the recession, and the scale and reach of the policy response will determine just how far. These remain unclear.

Downgrades are coming too. We think rating agencies have systematically over-rated non-financial corporate credit this cycle, paying too much attention to interest cover in particular – a backward-looking measure that fails to take into account loss of market access in a liquidity crunch and the downward shock to cashflows in a deep recession. Expect many fallen angels, particularly in lodging, restaurants, retail, gaming and commodity-related sectors.

Credit losses in BBs (defaults less recovery rates) were a cumulative 2.7% in 2008-09, per Moody's. But if some BBs are really Bs (watch for the coming downgrades), you must be compensated for Single B credit loss, which for 2008-09 was 7.3%. In CCCs it was 23%. And over a 5-year period that cumulative credit loss rises to >33% loss for CCCs. In a deep recession, spreads required to compensate for default alone (let alone illiquidity premia) clearly need to be very wide. A quirk of default history is that, for non-financials, the 2008 default cycle was not nearly as severe as 2002, so these aren't even worst-case numbers. It's not hard to make the case that CCC spreads should double.

HY outflows have only been 8% of AUM so far this cycle, whereas in 1999-2002 and 2014-16, HY mutual funds and ETFs saw between 18% and 21% outflows.

Strategic entry points

In the event of wider spreads, we expect to give back some performance on bonds purchased in the last 1-2 weeks, despite their historically attractive valuations. We view our recent and ongoing cyclical shift into credit as part of our gradual contrarian and value-based process. Value opportunities by their nature are supposed to make money over a strategic horizon, while giving up some P&L in the short term. To illustrate the point, if you bought credit in October 2008 (similar to current levels), you had to endure six months of negative mark to market, but then you made 16% in IG in 2009 and 60% in HY. We view the bid-ask of accumulating positions in March, and the possibility of some negative P&L in the short term as we average into a historic long-term value opportunity, as a down payment on hundreds of basis points of alpha over the next 12-18 months.

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What's on our shopping list?

On a cross-sectional basis, we find IG credit, especially long-dated USD IG primary, to be the best opportunity. In mid-March we closed our USD IG benchmark-relative underweight (with the market OAS >+225) and made the first adds in HY (with the OAS > +750), focusing on BBs. We took profits on iTraxx and CDX hedges, with spreads 350-400bps wider (consistent with HY OAS > +750). We are keeping it simple. We look for bottom-up balance sheet quality and cyclical resilience. While US corporations raised record gross debt over the last decade, in aggregate they also hold record cash piles. The challenge is that those with the cash and those owing the debt barely overlap! That is an opportunity: many AAA corporate bonds with liquid balance sheets traded cheaper than T+200 with Single As above T+300. These valuations don't come often – investors had to wait 27 years from the early 1980s to 2008 for similar entry points.

Across the spectrum, in our new purchases, we are avoiding perpetuals (both corporates and financials), second-tier and smaller banks and energy (save for European integrated national champions). We also continue to avoid new exposure in sub-5-year credit, where we expect an ongoing vicious bear flattening of credit maturity curves (happens every recession).

We see enough opportunity, anyway, in more plain vanilla credit, and with our benchmark OAS at <100bps, there is no need to reach for spread in the wilder reaches of the credit markets, when there are historic valuations in safer, cleaner segments. Against that, we are happy to take profits as we go, on bonds that have materially outperformed. Almost incredibly, some new issues from March have already returned 30%.

The umbrella broadens

Next, we favor EUR IG followed by non-energy BBs in EUR and USD. EUR IG spreads held in better than USD, as we expected, given the ECB CSPP program was already reactivated in November 2019. Mid-March spread peaks were only +240bps in EUR IG versus +400bps for USD IG.[2] Readers of previous Quarterly Outlooks will recall we described EUR IG as being "under the umbrella" of central bank purchases. With the Fed and BoE joining the ECB, the shift in new umbrella policies means less focus on EUR credit here, leaving USD with room for catch up performance. Still, we do expect a greater degree of government support, particularly in France and Germany. We note that French credits that get into economic trouble have frequently received state aid before (notably France Telecom in 2002), but help was also evident at Alstom and Areva. Different countries have different socio-political views on whether private sector companies should receive government help – and, if so, what conditions should be attached. That's probably beneficial for senior unsecured creditors, an additional safety net beyond CSPP. But its implications are less clear for junior securities. We call this the *Schumpeterian spectrum*.

Covered bonds offer little value and are another funding source for adds in the IG new-issue market.

Weaving credit into the broader Global Agg opportunity

We are also employing the broader Global Aggregate opportunity set. For commodity-type exposure, for example, we prefer FX exposure to the Norwegian krona, with its AAA sovereign, rather than owning upstream Single B/CCC US HY energy credits, many of which look unlikely to survive the commodity downturn.

As in sovereigns, EM credit looks vulnerable and may face many second-order effects. Top-down EM sovereign research is key. There are no prizes for buying the best Argentinean bank if the sovereign defaults. The same may apply to a range of more fundamentally challenged EM sovereigns over the next two years, potentially catching investors off guard.

Still, the strategic entry points are clear. Credit spreads usually don't hang around at recessionary wides for long. With USD IG at >400bps OAS and BBs reaching spreads of over 800bps in March, we already see unusually attractive long-term value. Credit research has become more important than ever. Defaults are never zero even in the best of times, let alone in deep recessions. Given that, it's critical to avoid the losers, a quest that becomes more intense the further down the quality spectrum or capital

[2] In this section, we use ICE BofAML indices COAO, EROO, HOAO and HOA1 for market OAS levels.

structure you go. So, there are great opportunities, but we are picking the names carefully and we're ready for a volatile near-term ride.

'The strategic entry points are clear. Credit spreads usually don't hang around at recessionary wides for long'

Please see the Robeco Credit Quarterly Outlook for more details.

Eurozone periphery: preference for short end
Given the extensive support programs as European budget and state aid rules are set aside, Eurozone sovereign debt levels are heading in one direction. The Maastricht Treaty, and the Stability and Growth Pact seem like a distant memory. Given the pandemic's foothold in Italy and Spain, the fragile debt dynamics of Italy in particular have come to the fore. Periphery spreads and 10s30s curves have already roundtripped, with 10-year spreads going wider after the initial ECB miscommunications at their scheduled press conference and recovery after the PEPP announcement in particular.

For us that has meant taking profits on our 10s30s flatteners during the volatility and switching our focus now to spread tighteners front-end. We may potentially add longer paper after ESM support has been clarified and announced.

Emerging markets debt: exposing quality dispersion
With the rapid spike in volatility and risk-off sentiment, but without the weight of ECB or Fed help, we view technicals for EM debt as negative. Year-to-date fund outflows continue in both EM fixed income and equity, totaling USD 53bn thus far, a higher magnitude than during past crises. Hard-currency (HC) bonds have experienced more redemptions than local-currency debt. As elsewhere, trading liquidity is poor, with wider bid-ask levels of between 2-6 percentage points. Ratings downgrades are increasing, particularly in oil-producing sovereigns. S&P's recent downgrades of Mexico and several Middle Eastern countries are a case in point. Downgrades are also taking back some of the IG upgrades of the last cycle – see Moody's downgrade of South Africa for instance. Valuation has become more attractive, but weighing the balance of risks, we are neutral on relative valuation compared to other asset classes and sectors.

For HC EM spreads, the quality dispersion continues, with EM high yield sovereign HC spreads compared to investment grade at record wides of over 400bps. In local currency, with EM central banks still proactively cutting rates, select EM rates look attractive on the surface. But, given the potential for EM FX volatility and different central bank response functions amid outflows, we are taking a cautious approach, considering allocations only very sparingly and only in higher-rated markets. We remain overweight Chinese rates whilst short the currency, and are underweight EM sovereign spreads.

FX

G10 FX – Mind the trend
FX markets are focused on the deep hit to growth and the ensuing policy response. While the latter has given a positive recent impetus to risk assets, the continued downside risks to growth should help the USD and JPY to stand strong as safe havens until summer. On the other side, EM FX and other cyclical currencies (AUD, NZD, CAD) may continue to weaken further.

On a medium to longer-term horizon we take a negative bias on the USD, mainly at the expense of the EUR and JPY. The fact that the Fed cut rates to zero and launched unlimited QE will likely prove to be a negative USD gamechanger down the road. A lot of new dollars will be printed, which is typically USD negative. Monetary policy should also push up inflation expectations over time. This comes on top of a widening fiscal deficit and an already-large current account deficit (textbook cause of weak FX). Real yield differentials versus other markets will be suppressed, turning the USD into a funding currency rather than a carry currency – a material shift.

For now though, we are not sure that QE matters a lot, and FX risk premia (funding stress) should dominate. In a new 'global lockdown', we would argue that EUR/USD could go to parity or even below. We are not ready to call for such a scenario as our base case, but consider this to be an important tail risk also in the FX space.

Emerging markets FX: depreciation trend to remain
EM FX, along with other risky assets, has been hit hard. Activation of temporary swap lines by the Fed to EM central banks like BoK, MAS, Banxico and BCB has clearly helped easing the USD funding crisis and fulfill USD demand. In previous Quarterly Outlooks we have written about the reality that many EMs face: growth is likely to be structurally low due to de-industrialization, localization and lower (commodities) demand from DMs. We are alert to a long list of bottom-up vulnerabilities in places,

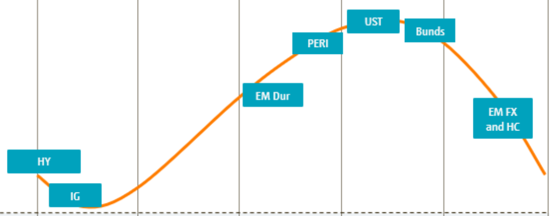
including high debt, short-term debt, current account deficits, external imbalances, political vulnerabilities, wealth inequality and a large share of informal sectors (if you haven't registered to pay tax, you are less likely to get a government handout now). The Covid-19 crisis makes the economic reality even worse for these countries. We expect the likes of Brazil and Mexico to be most exposed, prompting aggressive central banks rate cuts – putting downward pressure on their currencies.

While many EMs are ill-equipped in terms of healthcare capacity, they do have more experience in handling epidemic and natural disasters. Yet, the traditional EM business models of commodity exports, manufacturing and/or tourism, are clearly impacted. As in DM, the economic impact is difficult to quantify, but we would estimate Q2/Q3 GDP levels to fall by 10% to 30% annualized over the quarter, depending on the country and measures taken.

Some larger EMs have deleveraged or improved their current account positions since 2013. But smaller/frontier countries less so, particularly in Sub-Saharan Africa and parts of Eurasia. These countries face a daunting task, and high external vulnerability. Their large short-term external liabilities puts them at risk of being unable to borrow in international markets, and possibly even debt re-restructurings. This will weigh on sentiment in EM FX as a whole going forward. A key policy dilemma will be whether to provide liquidity to the domestic economy, or prioritize FX stability. This, in combination with USD swap lines, makes the depreciation of EM currencies a more gradual trend-like process. Frontier and small EMs already asked for funds from the World Bank/IMF, indicating there is no longer any stigma. Within EM FX, we favor shorts in ZAR, BRL, IDR, HUF, CNY versus EUR, USD and NOK.

Asset class positioning

Figure 2 | The market cycle



Market Phase	Bottom	Early Stage Recovery	Mid Stage Bull Market	Peak of Bull Market	Bear Market
Fundamentals	20% Improving but ignored	30% Solid underlying performance	40% Prolonged phase of supportive trends	20% Optimistic, long-duration projections	30% Over-awareness of deteriorating conditions
Valuation	20% Attractive, but no takers	50% Abundant bargains	30% Willingness to pay up	20% Revised models justify stretching	20% Shocked recognition of outlandish prices paid
Psychology, Technical and Liquidity	60% Exhaustion, disbelief and demoralization	20% Doubt, reflection and conversion	30% Faith, hope and charity	60% Euphoria, greed and extrapolation	50% Fear, panic and loathing

Source: Robeco, March 2020

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