



Asset Allocation Outlook

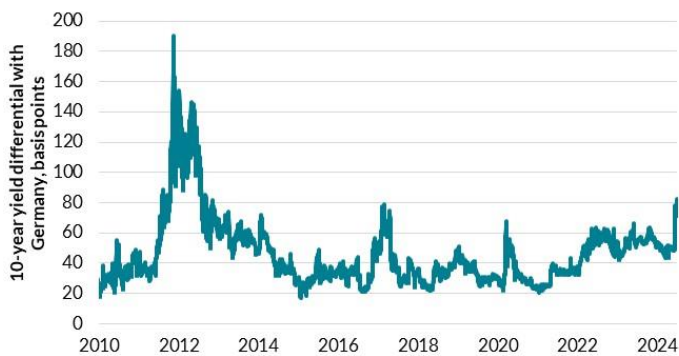
July 2024

- Political uncertainty in France leads to losses in Europe
- ECB cuts interest rates, Bank of England and Fed to follow suit
- Investment policy unchanged

European financial markets were rocked by the political uncertainty in France in June. After his party's poor European election results, French President Macron called early parliamentary elections. The possibility of a majority for far-right party Rassemblement National pushed yields on French government bonds up sharply and resulted in substantial losses for French equities.

We've kept our investment policy unchanged. Recent data from the US have confirmed our picture of economic growth. Eurozone data were worse than expected but we anticipate an upturn, especially in consumer spending. Earnings trends are positive in our view, and this is the reason for our overweight in equities.

Spreads on French government bonds widen sharply



Source: Refinitiv, Van Lanschot Kempfen

Spreads likewise widened in other Eurozone countries but only by a small amount. In contrast, the investor flight to German government bonds led to lower yields in Germany.

Yields also fell in the US, mostly due to the better-than-expected inflation data. Equities noted gains at a global level, driven by the US and emerging markets. The political turmoil in France pushed down European equities. European real estate declined as well. Spreads on credits widened marginally in the Eurozone.

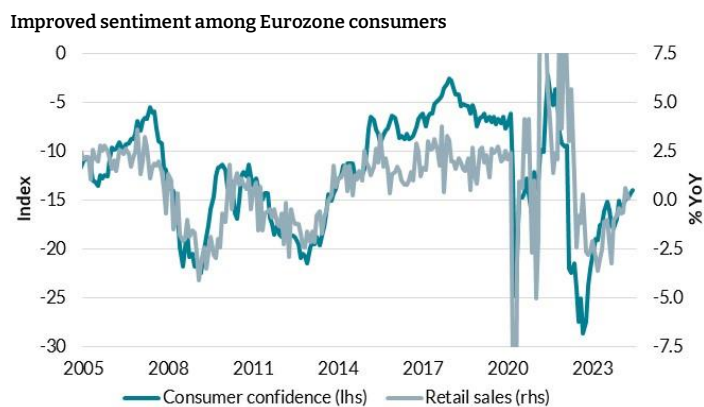
Political uncertainty in France

After President Macron called parliamentary elections, spreads on French 10-year government bonds widened to about 70 basis points. They even exceeded 80 basis points in the run-up to the first round of voting, although they subsequently tightened slightly in response to initial projections immediately after the first round. Nevertheless, we haven't seen spreads on French government bonds at such levels since 2017 when Macron faced Marine Le Pen in the presidential election. It's still unclear what the French parliament will ultimately look like. What is certain is that the centre, formed by Macron's party and a couple of associated parties, will suffer major losses. The wings are winning, with the right wing performing significantly better than the left wing. Strategic voting in the second round on 7 July could cause some shifts and in turn prevent the Rassemblement National from gaining a majority. This means there's a realistic chance of some kind of deadlock, in which none of the three main political groups holds an absolute majority and the sharper edges of the more extreme groups are blunted. French government finances were already a source of concern. Budget deficits of about 5% of the GDP cause national debt to grow. Rating agency S&P recently downgraded France's credit rating and it's likely that the European Commission will intervene and impose cuts and

reforms. This won't happen until the autumn, but it won't be easy to straighten out government finances in a divided and more Eurosceptic French parliament. If things go badly wrong and spreads widen too much, there's always the possibility of the ECB intervening on the bond markets. For the time being, however, the ECB won't object to bond investors clearly signalling the need to sort out French government finances. The situation surrounding French government bonds is likely to remain turbulent.

Recovery in the Eurozone?

In recent months we've written about positive signals for the Eurozone economy. The first quarter again saw growth and there were especially encouraging data from the service sector. We also said that growth wouldn't be exuberant and recent indicators confirm this outlook. The purchasing manager index (PMI) for the service sector was down slightly in June, although it continues to point to growth. After a minor upturn in May, the PMI for industry dropped again and points to a persisting recession in this sector. The Economic Sentiment Index likewise fell in June. Not by much, but this indicator has moved sideways since the start of this year, pointing to a stagnating economy. The indicator is emitting positive signals for the service sector and an improvement in sentiment among consumers.



The weakness lies in industry, construction and retail. The leading German Ifo index also declined marginally in June. Although the Ifo index has shown an upward trend this year, it would need to rise higher to point to economic growth.

What is remarkable given the low growth, but positive from the perspective of consumers, is the fact that the job market has remained tight. Unemployment dropped to 6.4% in April, a record low for the Eurozone. Growing employment and wages rising faster than inflation are a boost for households and their spending. Incidentally, we

don't expect exuberant growth here either. Firstly, in stark contrast to US consumers, households in the Eurozone have been cautious about spending their savings accrued during the coronavirus pandemic. Secondly, inflation hasn't yet been brought completely under control. Headline inflation stood at 2.5% in June versus a year earlier. Core inflation was unchanged at 2.9%. Inflation remains especially high in the service sector. At first sight, this sector seems to show signs of a wage-price spiral, in which wages and prices push each other upwards, but there are also strong indications that the current high wage increases are mostly a reaction to former rates of inflation. Once these have been factored in, wage increases will be able to moderate. For the time being though, inflation continues to make consumers in the Eurozone rather cautious.

Fewer concerns in the US

In the US, the sharp upturn in the PMI for the service sector seen in May continued in June, while the PMI for industry climbed slightly higher above the level that points to growth. The ISM indices were again marginally more pessimistic, however. In June, the ISM index for industry noted a level pointing to contraction for the third month in a row. Investment appetite among businesses is still low. Orders for capital goods were down in May. These orders have been moving sideways since the end of 2022. Does this mean companies are investing large amounts in IT? Even this type of investment is at a lower level than you'd think. Orders for IT products are also only growing slightly. The ISM index for the service sector has been volatile in the past few months and dropped sharply in June to a level that points to a minor contraction in the sector.

After stalling in April, consumer spending increased again in May. The data over preceding months were adjusted downwards. This will mostly be visible in the rate of growth over the whole second quarter, which as a result will be lower. Yet the underlying trend is reasonable. Versus May last year, consumer spending was up by 2.4% when adjusted for inflation. This is higher than the growth in real disposable incomes, which stood at 1.1%. This suggests that consumer spending growth is untenable. Weak growth therefore looks to be on the way, although downward inflation will help, especially at nominal income growth of about 4%.

May's inflation data were encouraging. The headline rate remained unchanged versus April according to both the CPI index and PCE index (the Fed's favourite). The CPI index had core inflation just reaching 0.2% and the PCE index rate stood at 0.1%. On an annual basis, core inflation fell to 2.6% according to the PCE index, its lowest level

since March 2021. The important thing to note here is that this monthly upturn is lower than the level implied by the Fed's projections for the rest of this year. At moderate growth and a job market that is cooling somewhat, this keeps the door open for cuts to interest rates.

US inflation falls further



Source: Refinitiv, Van Lanschot Kempen

The slowdown on the job market has so far been gradual. There are signs of weakness, such as weak growth in employment according to the survey of households, a decreasing number of job vacancies and a slight upturn in unemployment, but the number of announced redundancies has stopped rising for the time being and consumers have recently displayed greater confidence in the job market.

ECB takes the first step, when will the Fed and Bank of England follow suit?

As expected, and more or less announced by the ECB, the bank cut interest rates by 25 basis points to 3.75% in June. ECB President Lagarde found herself in rather a tricky position because inflation was worse than expected in the Eurozone in May. Furthermore, confirmation of lower wage increases so eagerly awaited by the ECB failed to materialise. So, the ECB raised its inflation forecasts for this year and Lagarde faced a problem in explaining the cut to rates. She solved this mainly by highlighting the ECB's stable inflation forecasts for 2026, which are consistently pointing to inflation heading for the ECB's target rate of 2%. This was all the more remarkable because until now the ECB has mostly looked to the past and found reasons for not cutting interest rates in the high wage increases and rates of inflation, even when economic growth was weak. And Lagarde kept the door open for further cuts to rates. The ECB will keep interest rates restrictive for as long as is necessary and is not committing to a specific path for rates. Lagarde initially denied that the ECB had entered a downward interest rate cycle but said later during her press conference that there's a high probability that it has.

In short, further interest rate cuts are in the offing this year.

ECB leading the way on interest rate cuts



Source: Refinitiv, Van Lanschot Kempen

The Fed kept interest rates unchanged. Fed Chair Powell explained he wasn't yet confident that inflation was heading towards the target rate of 2%. Most policymakers predict one to two cuts to rates this year, once again slightly fewer than before. Powell was also forced to go on the defensive, namely about the prospect of cuts to interest rate cuts when the Fed itself expects core inflation to stand at 2.8% at the end of this year, somewhat *higher* than the core inflation of 2.6% in May. Yet the Fed anticipates a less overheated, more balanced job market, weaker wage growth and slightly more progress on declining inflation. Moreover, monetary policy will remain restrictive according to the Fed. The first cuts to rates don't mean the Fed will start to stimulate the economy, only that it will ease its foot off the brake slightly. Powell called the Fed's inflation forecasts conservative and didn't attach too much importance to them. This was primarily because they didn't yet include May's better-than-expected data. In short, if inflation comes down marginally more quickly than the Fed's conservative forecasts, this could create capacity to cut rates this year. The first cut could come in September, but the timing of the next one will depend mostly on job market trends.

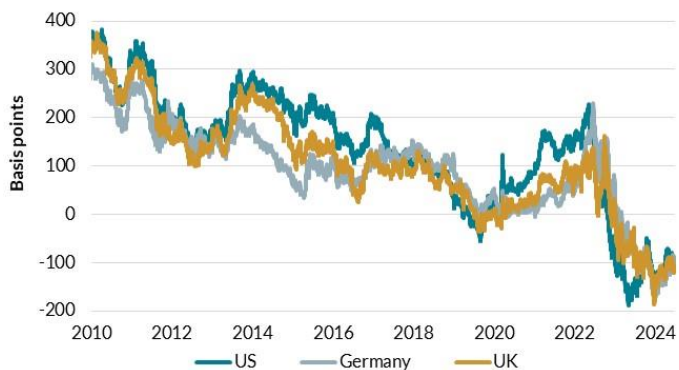
The Bank of England didn't alter its interest rates either, although this didn't come as a surprise. Just as at the previous interest rate meeting, two members voted in favour of cutting rates and the other seven voted to keep rates unchanged. Not even a downturn in inflation to 2.0% in May could soften the Bank of England's stance. Core inflation of 3.5% was still too high. There were two clues that the Bank of England wants to cut interest rates though. Firstly, the bank said that June's decision was balanced, which points to more policymakers tending towards cutting rates. Secondly, the bank will closely reexamine the extent to which the risks of stubborn inflation are declining when new forecasts become available in August. It's far from a promise but in central

banker jargon this translates into a hint. A cut to interest rates in August would also mean that the Bank of England is slightly ahead of the Fed in this respect.

Will long-term yields come down?

Lower inflation, moderate growth and central banks cutting policy interest rates. It would seem obvious that long-term yields will decline if all this happens. Although we think this is a possibility, we believe there's little capacity for them to come down very much. Government bonds will primarily have to make do with earning a return from the coupon rates, which have become significantly more attractive in recent years. The main reason for the limited potential for downturns in long-term yields is the inverse yield curves around the world. Long-term yields are already lower than short-term yields. How much lower varies but 10-year yields in the US, Germany and UK are about 100 basis points lower than their 3-month counterparts at the moment.

Sharply negative yield curves: bond investors expect lower yields



Source: Refinitiv, Van Lanschot Kempen

A negative yield curve is fairly unusual and traditionally a precursor of a recession. If central banks succeed in achieving a soft landing for the economy, in which the economy slows enough to get inflation under control without causing too much damage, such as a recession, then this will be exceptional. Yet in this case yields at the short end of the curve would only come down by a small amount and long-term yields have already priced this in as they're already lower.

Another aspect is the state of government finances. We've already seen in the autumn of 2022 in the UK and more recently in France that concerns about government finances can push yields up sharply. Bond markets have a strong disciplinary effect on governments. Higher deficits and higher yields mean that turbulence on the bond markets cannot be ruled out. If investors want to be

rewarded for that higher risk, this restricts the extent to which yields can fall.

In the US, budget deficits are exceptionally high for a period in which the country is not at war or in a recession and the level of national debt is rising. Politically there's very little desire to do anything about the deficits. This wasn't a problem when interest rates were low, but interest payments are rising fast now that rates are higher.

US government interest payments rising fast



Source: Refinitiv, Van Lanschot Kempen

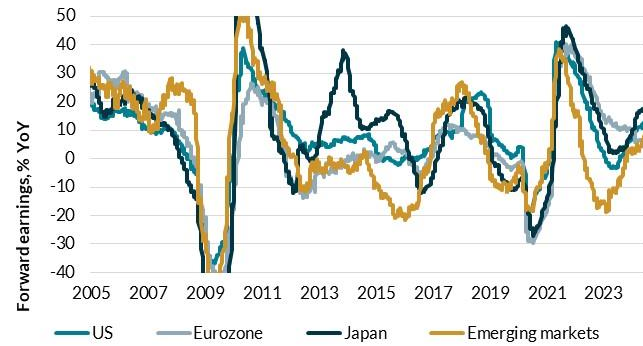
It's hard to predict when investors will decide they've had enough. So far, the economic cycle and outlook for monetary policy have dominated the path taken by market interest rates in the US. Yet here, too, an expansionary budgetary policy, potentially including high import duties under a Trump administration, will prevent long-term yields from coming down. Incidentally, the US has one huge advantage, namely the US dollar. It continues to be the world's reserve currency and there's simply no alternative. No other country has such deep and open capital markets as the US. This is why there will always be high demand for US securities, especially government bonds.

Investment policy unchanged

The Eurozone's economic data have been marginally worse than expected in recent months. Many data are slightly lower than forecast in the US too. When combined with stubborn inflation in the service sector and central banks cutting interest rates by less than had been expected a few months ago, this could prove to be negative for equities. Yet the trend is still positive in the US and equities look be bottoming out in the Eurozone following the shock French election results. Japanese equities have enjoyed two sound weeks, despite a downturn in the Japanese yen. Equities are being shored up by earnings growth. Businesses in the US and Eurozone are managing to maintain their margins. Realised earnings are increasing at a slightly higher rate in the US than in the Eurozone but both regions are experiencing growth. The same cannot be said for the UK

and emerging markets. Growth in expected earnings is strongest in Japan, followed by the US, emerging markets and Eurozone.

Earnings growth positive for equities



Source: Refinitiv, Van Lanschot Kempen

However, the breadth of revisions to earnings, or the net number of analysts adjusting earnings upwards, is narrower in the US and emerging markets than in the Eurozone and Japan. Given the positive earnings trends overall in the US and Europe and the prospect of interest rates being cut in the US, Eurozone and UK, we've decided to retain our overweight in equities.

We hold an underweight in bonds. We particularly find US investment grade credits unattractive as we believe the tight spreads offer insufficient reward for the higher risk versus government bonds. Spreads only need to widen slightly for the asset class to underperform versus government bonds. Within US investment grade bonds, we prefer government bonds. However, when it comes to global investment grade government bonds, we prefer the Eurozone. We think there's a bigger chance of yields coming down there and spreads on investment grade credits aren't as tight as they are in the US.

We're more cautious about high yield credits as these companies are more aggressively financed and therefore affected more by higher interest rates. Emerging market debt generates an attractive return but the strong US dollar and turbulence this is causing on the currency markets in emerging markets show that there are risks. This is the reason for our neutral position.

For real estate, we continue to view the uncertainty surrounding interest rates and potential downgrades to property valuations as too high to build a position in this asset class. As for commodities, our doubts mainly relate to the robustness of the Chinese economy.

Market review

Equities

	Index	Past month	Past 3 months	From 31-12-2023
Global (MSCI AC)	1080	2.7%	3.8%	11.0%
Developed markets (MSCI World)	3538	2.7%	3.9%	11.6%
Emerging markets (MSCI EM)	1080	2.9%	2.8%	5.5%
United States (S&P500)	5509	4.4%	5.8%	15.5%
Eurozone (EURO STOXX 50)	503	-2.5%	-2.5%	6.1%
United Kingdom (FTSE 100)	8121	-1.9%	2.3%	5.0%
Japan (Topix)	2857	3.0%	5.2%	20.7%
Netherlands (AEX)	925	2.3%	4.9%	17.5%

Government bonds (10-year)

	Yield (%)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	4.43	-5	8	57
Japan	1.11	3	36	48
Germany	2.61	-4	20	58
France	3.33	19	41	77
Italy	4.08	11	27	36
Netherlands	2.92	-2	24	60
United Kingdom	4.25	-7	16	71

Investment grade credit

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	93	5	0	-11
Eurozone	110	3	-2	-25

High yield bonds

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	323	3	0	-11
Eurozone	340	11	-18	-55
Emerging markets (USD)	398	17	57	14
Emerging markets (Local currency)	223	12	26	-12

Real estate

	Past month	Past 3 months	From 31-12-2023
Global	-0.5%	-1.2%	-5.7%
North-America	1.5%	1.4%	-3.3%
Europe	-3.7%	0.4%	-5.2%

Commodities

	Past month	Past 3 months	From 31-12-2023	
Bloomberg index	-1.7%	0.5%	2.6%	
Base metals	-6.0%	6.4%	5.8%	
Brent oil (USD per barrel)	87.01	6.4%	-2.1%	12.0%
Gold (USD per troy ounce)	2329	-0.1%	3.1%	12.8%

Returns in local currency

bp = basis point (0.01%)

Data as of 3 July 2024

Source: Refinitiv

Tactical outlook

Asset class	
Equities	Overweight
<p>The MSCI global equity index climbed in June against a background of falling bond yields in the US, Germany and UK. Equities made gains in the US and emerging markets, slight losses in the Pacific region and larger losses in Europe. European equities underperformed after parliamentary elections were announced in France, resulting in much greater political uncertainty. France's CAC40 equity index fell by almost 9%. The outlook for the economic cycle continues to be crucial for equities. As long as the US economy continues on the path towards a soft landing and earnings continue to grow, we don't think US equities will enter into a long-term downward trend. In Europe, we're seeing the economy picking up and the ECB cutting interest rates, while earnings expectations are realistic and valuations reasonable. Earnings expectations are being adjusted upwards in both the US and Europe, which could boost equity prices. We hold a neutral position in Pacific and emerging markets. In Pacific we recently took profit on an overweight in Japan and harbour doubts about Hong Kong. We don't consider the growth, momentum and revisions to earnings in emerging markets to be robust enough for us to hold an overweight in these.</p>	
Government bonds	Overweight
<p>US bond yields declined on balance in June. Two-year yields came down by 15 basis points and their 10-year counterparts 12 basis points. Despite better-than-expected inflation data, there was little change to monetary policy expectations. Markets are assuming two cuts to interest rates this year, but we still think this is on the conservative side. If the economy slows further and inflation comes down slightly more, there will be room for further cuts. Market interest rates could then also come down, especially at the short end of the curve. We hold an overweight in US government bonds, although this is mainly due to our underweight in US investment grade credits. Bond yields also declined in the UK, by 19 basis points at the short end of the yield curve and 15 basis points at the long end. An interest rate cut by the Bank of England in August has been priced in for 60%. In Germany, 2-year bond yields decreased by 26 basis points and 10-year yields by 16 basis points. This was partly caused by an investor flight from French government bonds, where spreads on 10-year bonds widened by 31 basis points. The ECB has started to cut interest rates but will be in no hurry to implement further cuts given the accelerating growth and stubborn inflation in the service sector. As 10-year bond yields are considerably lower than 2-year yields, we think yields at the long end of the curve are unlikely to come down much.</p>	
Investment grade credits	Underweight
<p>Spreads on US investment grade credits widened by 8 basis points and in the Eurozone by 10 basis points in June. We think the tight spreads are at odds with economic indicators that in many cases are pointing to a slowdown in growth in the US and moderate growth in the Eurozone. Furthermore, the higher market interest rates are causing a deterioration in the ratio of corporate results and interest charges. Exposure to commercial real estate poses a risk for some US and German banks. US spreads are 30 basis points below the average for the past five years, Eurozone spreads 14 basis points. Spreads currently account for a historically small portion of the interest compensation on credits. This makes them less attractive versus government bonds. Within investment grade credits we have a relative preference for the Eurozone versus the US. Spreads are marginally wider in the Eurozone and interest rate sensitivity is lower.</p>	
High yield credits	Underweight
<p>Spreads on US high yield credits remained more or less unchanged in June. In the Eurozone, spreads widened by 19 basis points, resulting in a small positive return. Like investment grade credits, high yield credits have lost some of their relative attractiveness versus government bonds thanks to the higher yields in the latter asset class. Yet our negative outlook for this asset class primarily derives from the fact that the market for high yield bonds is totally ignoring the possibility of a further slowdown in growth. However, even if the economy continues to grow over the coming quarters, we still view the spreads as small. This is because companies will face higher interest charges. Moreover, US consumers have now spent their (surplus) savings. And the fact that default rates on their credit card and car loans are rising fast is a bad sign. Furthermore, we know that if the solid sentiment on this market deteriorates, the liquidity of these bonds will quickly dry up and spreads will widen.</p>	

Asset class	
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Emerging market debt	Neutral
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Emerging market debt issued in US dollars earned a positive return in June. Interest compensation was more or less unchanged following a widening of spreads* and a downturn in the underlying US yields. Spreads were also virtually unchanged for bonds listed in local currency. The return on these was fairly flat as EM currencies declined in value somewhat against the euro. We find the interest compensation on emerging market debt issued in US dollars attractive and spreads are relatively wide versus other asset classes. Stubborn inflation in the service sector and high interest rates in developed countries pose risks but we ultimately expect the Fed to be able to cut interest rates this year as inflation is coming down in the US. Emerging market debt listed in local currency could profit from the lower inflation and cuts to interest rates in emerging markets. However, the interest compensation is relatively low versus developed countries and this reduces the relative attractiveness.

*) The addition of Venezuela to the EMD HC index (in three steps between the end of April and the end of June) has led to a mechanical increase in spreads.

Listed real estate	Neutral
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The relatively high amount of debt financing means that rising interest rates and stricter lending conditions at banks pose risks to listed real estate, including in relative terms versus general equities. The global index for listed real estate was largely unchanged in June. Gains in the US offset losses in other regions. Some signs of a slowdown on the US job market and better-than-expected inflation data pushed down interest rates there. Listed real estate underperformed in Europe. Inflation rates are gradually heading in the right direction, but inflation remains strong in the service sector. German yields did decline slightly, but this was mostly due to the turmoil surrounding the French parliamentary elections. We hold a neutral outlook for this asset class. Valuations are relatively low versus general equities but not versus interest rates. In the short term we don't anticipate interest rates coming down enough and continue to be extremely concerned about financing in the real estate sector. Tighter lending conditions at banks complicate access to (re)financing and exert upward pressure on interest charges. Despite the fact that transactions have recently picked up somewhat, they remain at low levels. Property prices could continue to fall before the number of transactions normalises further.

Commodities	Neutral
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Oil prices climbed in June, but lower prices for precious metals, metals and agricultural products pushed down the Bloomberg general commodity index. Oil markets are tight and stocks low, but the knowledge that the OPEC countries have sufficient production capacity and are being sensible about this restricts the upward potential for oil prices. The downturn in metal prices is remarkable. It tells us something about the speculative nature of recent price increases for some metals but also about the doubts that investors have about the global economy. Uncertainty about the Chinese economy particularly plays a role here. The gold price remained virtually unchanged. The high gold price is primarily the result of expansionary monetary policies and the large amount of liquidity these have created, as well as gold purchases by central banks. Gold is an interesting investment at times of uncertainty but given its high price a large amount of uncertainty and/or lower interest rates have already been priced in.



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