VAN LANSCHOT KEMPEN

INVESTMENT MANAGEMENT

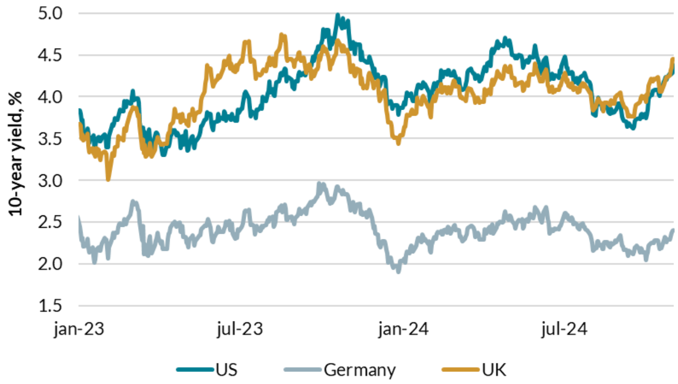
Asset Allocation Outlook

November 2024

– US equity markets gain after US elections, Europe retreats
– Economy and earnings stronger in US than in Europe
– Equity overweight slimmed down slightly

Although sentiment on the markets was mostly positive in October, many equity markets still closed the month down. The loss was small in the US, with Europe and emerging markets earning marginally larger losses. The Japanese equity market succeeded in noting a gain. Bond yields climbed sharply in the US and UK. This had little impact on equities during the greater part of the month, partly because yields had declined in the preceding three months. Yet at the end of the month the higher yields started to worry equity investors after all, incidentally without affecting general sentiment too much. Spreads tightened on government bonds issued by Southern European countries, investment grade and high yield credits and emerging market debt in October.

Bond yields climb again in October



Source: Refinitiv, Van Lanschot Kempen

We increased the equity weight in our investment policy to an overweight earlier this year. Since then, the positive return on global equities has contributed positively to portfolio performance. Before the US presidential elections, we saw a chance of increased volatility on financial markets in general and on equity markets in particular. We had therefore slimmed down the equity weight slightly, although we continue to hold an overweight. The weight in Europe has been reduced from an overweight to neutral given the moderate economic outlook and weakening earnings dynamics.

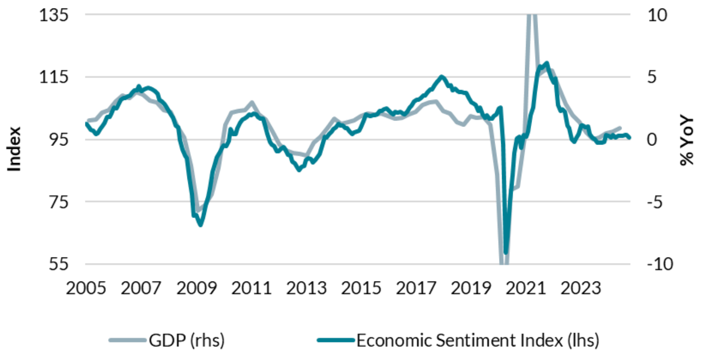
Trump re-elected

The polls in the US had pointed to a neck and neck race between between Vice President Harris and former President Trump. But in the end Trump posted a solid victory, with the Republican Party also winning a majority in the Senate and possibly in the House of Representatives. That would give Trump ample leeway to implement his foreign and domestic policies. Trump stands for international confrontation and the widespread introduction of import duties. This is a risk for equity markets outside the US. Trump wants to continue previous tax cuts, slash corporate tax even more and deregulate the economy. However, Trump's inflationary policy could also have a negative impact on equities via higher bond yields. The enormous US budget deficit won't shrink and may even widen further. The day after the elections US equities gained about 2%, while European equities lost about 0.5%. Emerging market equities fell close to 2%. Given the uncertainties about future US policies, we had reduced our equity overweight somewhat before the election. We kept our overweight in the US but reduced our exposure to European equities from overweight te neutral. This was not just about political risk, the weak economic growth and earnings expectations in Europe were just as important.

Growth in Eurozone, but...

The Eurozone economy surprised analysts with growth of 0.4% in the third quarter versus the second quarter. On an annual basis growth accelerated to 0.9%, its fastest rate since the first quarter of 2023. The Spanish economy continued its robust rate of growth of the past four quarters, while French economic growth accelerated. Germany caused a surprise with a small plus but only after a downward adjustment to growth in the second quarter. In doing so, Germany avoided the feared technical recession of two consecutive quarters of contraction. Growth dropped back to zero in Italy, where fiscal stimuli for households expired. All in all, a more robust rate of growth than expected for the Eurozone, but we don't view this as sustainable.

Eurozone leading indicators point to stagnation



Source: LSEG, Van Lanschot Kempen

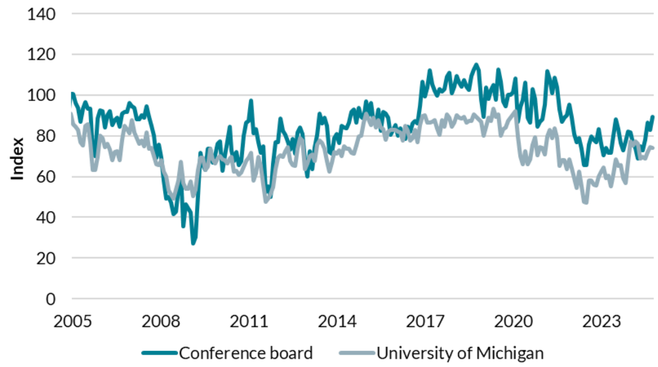
Leading indicators in fact show that the green shoots we saw back in the spring are suffering from a lack of water over the summer. The purchasing manager index (PMI) for the whole economy remained in the 50s in October, pointing to stagnation. A minor improvement was visible in industry, but the situation remains weak, and the index for the service sector fell again slightly. The downturn in the French service sector is particularly noticeable. The optimism surrounding the Olympic Games looks to have made way for pessimism about the wide range of tax increases and spending cuts announced by the new government. The Economic Sentiment Index, Germany's Ifo index and France's INSEE index likewise point to no more than an ailing economy. The fiscal consolidation that will take place especially in France and to a lesser extent in Italy, however essential from a longer-term perspective, will curb growth somewhat.

Incidentally, there are still bright spots. One of these is consumer spending. The growth in purchasing power means consumers have the capacity to spend more. Consumer confidence is up from extremely pessimistic to neutral and retail sales are growing slightly after downturns in 2022 and 2023. Yet at moderate growth and a potential slowdown on the job market, there's a risk of European consumers retreating into their shells. Another bright spot is that banks are generally not tightening their lending conditions any further for businesses and are in fact easing them for mortgages. Banks are seeing a strong upturn in demand for mortgages, although this isn't yet visible in the data on actual lending. Lending to businesses and households is no longer declining but it isn't really increasing either.

US barrel along

US economic growth over the third quarter was marginally lower than expected, but at 0.7% growth versus the second quarter there's nothing remarkable about that. All the more so as the growth was domestic. Foreign trade and the build-up of stocks made a negative contribution to growth, but the contributions from consumer spending, government spending and investments were in fact positive.

US consumers getting more confident



Source: LSEG, Van Lanschot Kempen

Leading indicators depict a more positive picture in the US than in the Eurozone. While it's true confidence indicators are weak in industry, just as in the Eurozone, they're much stronger in the service sector. According to the indicator published by the Conference Board, consumer confidence climbed sharply in October. It was the biggest monthly upturn since March 2021 and the highest level since July last year. Consumers were more positive in their outlook and in their assessment of the job market. The University of Michigan indicator puts optimism at a lower level among consumers, but this indicator likewise shows an improvement.

Job market data have displayed a rather mixed picture in recent months but overall point to a slight slowdown without a sharp deterioration. Job growth was robust in September and unemployment fell for the second month in a row. However, the number of unfilled vacancies declined, fewer employees voluntarily resigned their jobs and the number of compulsory redundances increased. As there continue to be more unfilled vacancies than unemployed and a low number of jobless claims, this translated into a healthy slowdown in the job market. October brought worse data with it. Employment barely increased and unemployment mainly stayed the same because fewer people are seeking a job. The total number of hours worked was down. Yet the October data are depressed by strikes and the hurricanes that hit the US. The strikes had a temporary negative effect of about 40,000 jobs; the impact of the hurricanes is still hard to estimate. One encouraging aspect is that consumers have recently become more confident about the job market and the number of jobless claims fell to its lowest level since April in the last but one week of October.

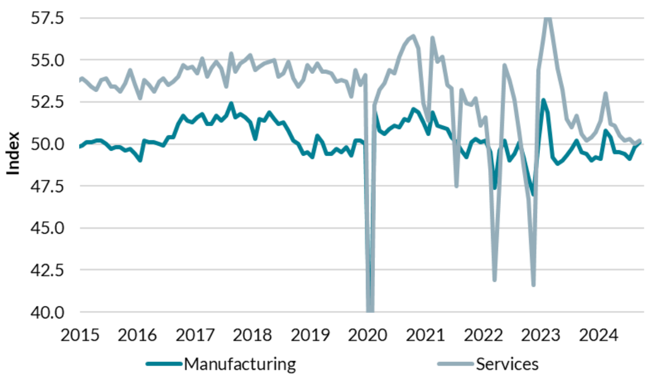
In conclusion, we foresee persistent growth in the United States.

Chinese growth picks up somewhat

Last month we wrote that we didn't view the monetary and fiscal measures announced by the Chinese government as decisive in combating the real estate crisis and the risk of a long-term period of deflation. Our opinion remains unchanged, although there could be some positive effects in the short term. The lack of stimuli for the demand side nevertheless means we aren't positive about this.

A minor improvement is visible in the PMIs in October, however, without these pointing to growth picking up strongly. It was too soon to see an improvement in lending in September. The fact that retail sales and industrial production were slightly better in that month wasn't due to the fiscal and monetary stimuli either. The economy enjoyed marginally higher underlying momentum in September. The housing market remains exceedingly weak at a downturn in prices of 9.1% for existing homes versus September 2023.

Chinese purchasing managers indices gain somewhat



Source: LSEG, Van Lanschot Kempen

Economic activity has recently declined somewhat on balance in other emerging markets. The upturn in industry visible in the PMIs earlier this year has dropped again slightly. This can also be seen in manufacturing data and exports. A trade war between the US and China, a real risk in light of the US election, could lead to production facilities moving from China to more US-friendly countries. Incidentally, whether production there is safe from US import tariffs remains to be seen based on campaign remarks by Trump.

The BRICS countries (originally Brazil, Russia, India, China and South Africa, now much expanded) recently held a summit to discuss economic cooperation. It's a sign of the times in which institutions such as the IMF dominated by industrialised nations are losing prestige and influence. The BRICS summit discussed a digital payment system in local currencies aimed at breaking the US dollar's dominance. Yet given the political differences between the countries, the fact that many of these countries have a trade surplus with the US and therefore earn revenue in US dollars, the large amount of debt listed in US dollars and the unparalleled liquidity of the financial markets in the US, we don't anticipate any substantial erosion of the influence of the US dollar in the near future.

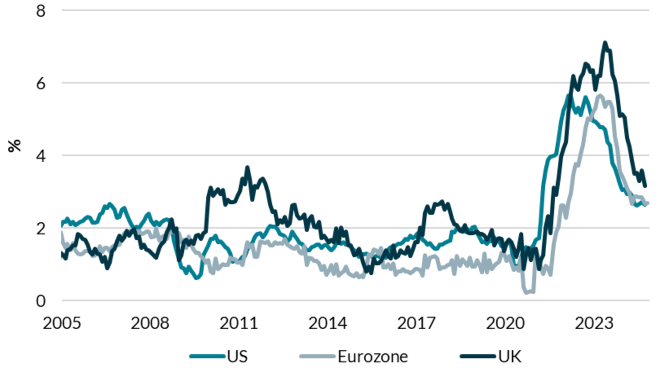
Higher bond yields

Bond yields have climbed sharply in the past few weeks. In the US, 2-year yields increased from 3.5% at the end of September to 4.1%. Ten-year yields have undergone a similar upturn. In the UK, both 2-year and 10-year yields have risen from just below 4% to 4.4%. German bond yields have grown by a more modest amount: 2-year and 10-year yields climbed by about 0.3 percentage points to 2.3% and 2.4% respectively.

The higher bond yields are partly a reaction to the slightly excessive downturns up to mid-September. Bond yields stood at higher levels in the spring and early summer than they do now. Yet there are also fundamental factors at work, especially in the US and UK.

The outlook for growth has improved in the US. This higher growth could stop inflation from coming down. Headline inflation fell in October, but core inflation was unchanged. Overall, according to the PCE index core inflation has stood at 2.7% since June, above the target rate of 2% set by the Fed. The Fed has a dual mandate as it also seeks to achieve full employment. A slowing job market gives the Fed the opportunity to cut interest rates, despite the target rate of inflation not being met. However, markets are now pricing in fewer cuts to interest rates. Rates will almost certainly be cut on 7 November, the date of the Fed's next policy interest rate meeting, but the Fed could well introduce a pause after that. This would push up bond yields. In addition to perceptions relating to monetary policy, budgetary policy could also play a part. Concerns about the enormous budget deficit have been mentioned but these concerns existed a month ago too. The increased probability of a Trump victory may have played a role here. Not only due to the potentially even larger deficit under Trump, but also the inflationary effect of a fiscal boost and import duties. Indeed, yields rose further after Trump's victory was clear.

Core inflation no longer falling



Source: LSEG, Van Lanschot Kempen

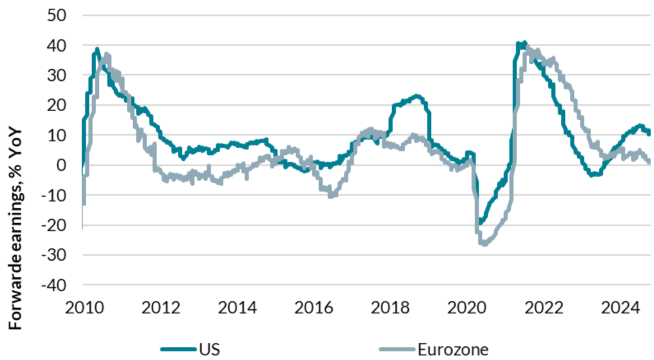
UK bond yields shot up following presentation of the new Labour government's budget. Attention focused on the substantial tax increases worth about 1% of the GDP. This will mostly have to come from employers and partly from higher taxes on wealth. Yet as spending is being increased by about 2% of the GDP (two-thirds of which on current expenditure and one-third on investment), the government deficit will be higher. According to the Office for Budget Responsibility, this is the largest fiscal loosening in the past few decades. As the additional spending will have an effect sooner than the tax increases, this will boost growth in the short term. Inflation may prove more stubborn as a result and the Bank of England may cut interest rates less quickly. In this sense, the response from the bond market was better than expected, although the Labour government would have hoped for a better one given its emphasis on fiscal responsibility. However, a Truss moment - named after the panic on the bond markets following the announcement of tax cuts without budget cuts in September 2022 - failed to materialise. This time the emphasis was on investment rather than tax cuts and the data had been verified officially. This has created less of a picture of irresponsible fiscal policy.

There's little reason to expect higher bond yields in the Eurozone. We believe that at the current rate of growth and outlook for inflation German bond yields could rise as high as 2.5% but not much higher. The deterioration in leading indicators has led to increased speculation about the ECB cutting interest rates by 0.5 percentage points. However, at growth of 0.4% in the third quarter and core inflation that stood at 2.7% in October and has in fact been stable for six months, we don't anticipate an acceleration in interest rate cuts from the ECB. We expect the coming meetings to keep cuts at 0.25 percentage points.

Sound US earnings data

About 70% of the companies in the S&P500 equity index have already reported their earnings over the third quarter. The results are sound. At nearly 9% earnings growth versus the third quarter of last year, the data are better than expected. Average revenue growth of 5% is likewise better than expected. The weakness in industry shown in the macro-economic data is also visible in the earnings data. Earnings are declining in the energy, basic industrial and industrial sectors. The big tech companies traditionally account for a significant portion of the upturn in earnings but a broadening is visible too. The number of companies causing a positive surprise is average at 75%. The number of companies adjusting earnings expectations upwards is higher than in the previous quarter and higher than average. A smaller majority of equity analysts is adjusting earnings downwards but the extent to which they're doing so is small. On balance, forecast earnings for 2025 remain at the same level. We view the earnings growth as positive for US equities.

US earnings stronger than in Europe



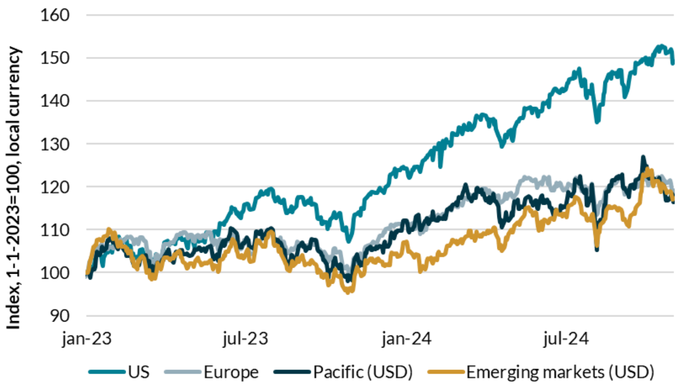
Source: LSEG, Van Lanschot Kempen

We're more concerned about earnings in Europe. Reported earnings growth over the third quarter is just 1.5%. Whereas last year companies succeeded in keeping their earnings at the same level in the face of a stagnating economy and rising prices, they now seem to be experiencing greater difficulty in doing so. Those companies that have already published quarterly results are on average reporting a minor downturn in revenue. A relatively small number of companies have been able to meet revenue forecasts. Earnings dynamics are weaker in Europe than in the US. The number of analysts adjusting earnings expectations downwards is significantly larger than in the US. Moreover, expected earnings for 2025 are much lower. Against this background, the sideways movement of the European equity index over the last few months isn't so bad. The ailing European economy and weakening earnings dynamics are the main reasons for reducing our overweight in European equities to neutral.

Equity overweight slimmed down

In our investment policy we increased our equity positioning to an overweight earlier this year. We saw improvements in the European economy, while the US economy caused surprises time and again. Downward inflation enabled central banks to cut interest rates and there was an improvement in corporate earnings. This picture hasn't changed in the US. It's mostly been US equities that have contributed positively to the return on our portfolios. Before the US elections we had decided to slightly slim down the equity overweight, which had grown due to higher equity prices. We foresaw increased risk of volatility around the US elections, but the disappointing growth and earnings trends in Europe were more important. This is why we've opted to reduce our overweight in Europe to a neutral position.

US equities have outperformed



Source: LSEG, Van Lanschot Kempen

Our investment policy is otherwise unchanged. We hold an underweight in bonds. US investment grade credits are particularly unattractive in our opinion 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 credits, we prefer government bonds. However, when it comes to global investment grade credits, we prefer the Eurozone. Spreads on investment grade credits aren't as tight there as they are in the US.

We're cautious about high yield credits as these companies are more aggressively financed and therefore affected more by higher interest rates that gradually work their way into interest charges when credits are refinanced. Emerging market debt generates an attractive return, but this mostly derives from the extremely high yields in the weaker countries in the index. Little risk premium has so far been priced in for the turbulence surrounding the US elections in November and any further slowdown in growth. This is the reason for our neutral position.

We don't think this is the right time to build a position in real estate. Versus interest rates, valuations are expensive in global developed countries and neutral in Europe in our opinion. Interest charges are rising as debt is refinanced. As for commodities, we have doubts about the robustness of the Chinese economy and think the supply of oil is sufficient. A clear sign as far as we're concerned is the fact that oil prices have fallen in recent months despite increased geopolitical tensions in the Middle East.

Market review

Equities

	Index	Past month	Past 3 months	From 31-12-2023
Global (MSCI AC)	1139	-0.5%	10.6%	16.0%
Developed markets (MSCI World)	3693	-0.1%	10.5%	16.5%
Emrging markets (MSCI EM)	1139	-3.4%	12.1%	11.3%
United States (S&P500)	5783	0.6%	11.5%	21.2%
Eurozone (EURO STOXX 50)	504	-1.5%	6.5%	6.2%
United Kingdom (FTSE 100)	8172	-1.3%	2.0%	5.7%
Japan (Topix)	2664	-1.1%	19.6%	12.6%
Netherlands (AEX)	883	-3.2%	2.6%	12.2%

Government bonds (10-year)

	Yield (%)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	4.29	31	51	42
Japan	0.92	3	13	30
Germany	2.43	22	25	40
France	3.17	18	19	60
Italy	3.68	17	1	-3
Netherlands	2.69	18	19	37
United Kingdom	4.53	40	66	99

Investment grade credit

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	84	-3	-28	-20
Eurozone	101	-9	-26	-34

High yield bonds

	Risk premium (bp)	Past month (bp)	Past 3 months (bp)	From 31-12-2023 (bp)
United States	286	-3	-107	-48
Eurozone	318	-15	-84	-77
Emerging markets (USD)	344	-7	-86	-40
Emerging markets (Local currency)	220	-22	-45	-15

Real estate

		Past month	Past 3 months	From 31-12-2023
Global		-2.4%	7.4%	4.3%
North-America		0.2%	8.4%	9.3%
Europe		-7.7%	0.9%	-3.2%

Commodities

		Past month	Past 3 months	From 31-12-2023
Bloomberg index		-2.9%	5.5%	0.5%
Base metals		-3.2%	10.9%	5.8%
Brent oil (USD per barrel)	76.09	-2.7%	-0.5%	-2.1%
Gold (USD per troy ounce)	2742	2.8%	13.9%	32.8%

Returns in local currency
bp = basis point (0.01%)
Data as of 5 November 2024
Source: Refinitiv

Tactical outlook

Asset class	
Equities	**Overweight**
Japanese equities climbed in October, but US and European equities noted losses. It's worth noting though that the losses were smaller in the US than in Europe. This can be explained by the economic outlook. The US economy grew soundly again in the third quarter and the outlook is stable. The Eurozone economy also had a good quarter in terms of growth, but the outlook has deteriorated somewhat. Earnings dynamics are likewise better in the US than they are in Europe. The difficulties US equities experienced in October were caused by the higher bond yields. The positive outlook for growth enabled equities to stand up to these well for a while, but even this has its limits. As the Fed and ECB will cut policy interest rates further, we don't anticipate a lasting negative effect from the bond markets. We've slightly slimmed down our overweight in equities. Potential volatility surrounding the US elections played a role in this decision, but it was mostly down to the worse outlook for growth and deteriorating earnings dynamics in Europe. We've reduced the equity weight in Europe to neutral for this reason. We continue to hold an overweight in the US and a neutral position in the Pacific and emerging market regions.	
Government bonds	**Neutral**
Bond yields increased significantly in the US and UK in October. In the UK, short and long-term yields climbed by the same amount, while in the US short-term yields rose more sharply than their long-term counterparts. The steepness of the yield curve remained positive in the US, however. In the UK, the upward pressure on yields was exacerbated by the new Labour government's fiscal plans, which will lead to higher government borrowing. The upturn in bond yields was smaller in Germany. The higher yields follow downturns in yields in preceding months and are a reaction to sound growth in the US and core inflation moving sideways. Considerably fewer interest rate cuts are now expected of the Fed than a few months ago. In the US, the presidential elections are also casting their shadow over the bond market, mostly due to a higher risk of inflationary policy under Trump's presidency. Last month we warned of higher yields in the short term. However, there's little upward potential from current levels. We expect inflation to come down further and central banks to continue cutting interest rates.	
Investment grade credits	**Underweight**
Spreads on US investment grade credits tightened for the third consecutive month in October. In the Eurozone, October's contraction completely cancels out the widening of spreads in August and September. The bigger upturn in the underlying yields on government bonds means that investment grade credits generated a negative return. We find spreads extremely tight in the US and therefore view investment grade credits as unattractive versus government bonds. The economic outlook for the US has improved in the short term, but spreads only need to widen by a small amount for investment grade credits to underperform versus government bonds. Spreads are tight in the Eurozone too but at less extreme levels than in the US. In the Eurozone, spreads account for a much larger portion of the total interest compensation than in the US. This reflects the less positive outlook for the Eurozone, but we don't believe it's so negative that spreads on relatively safe credits will widen. Within investment grade credits we have a relative preference for the Eurozone versus the US.	
High yield credits	**Underweight**
Spreads on US and Eurozone high yield credits tightened for the third consecutive month in October. This is a sign of the positive sentiment on the financial markets. Positive sentiment that stood firm in the face of minor downturns on some equity markets in October. Spreads in the US and Eurozone are still well below the average for the past five years – nearly 130 basis points in the US, over 100 in the Eurozone – and an extremely positive economic scenario has been priced in. 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 cautious outlook for this asset class primarily derives from the fact that the market for high yield bonds is totally ignoring the possibility of a slowdown in growth. 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. 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.	
Emerging market debt	**Neutral**
The positive sentiment was felt by emerging market debt listed in US dollars in October as well. Spreads tightened for the third month in a row. Yet this asset class was also affected by the underlying upturn in US yields. The interest compensation was higher on balance. An upturn in yields was also visible among bonds listed in local currency. The small downturn in inflation stopped yields from declining. We find the interest compensation on emerging market debt issued in US dollars attractive and spreads are relatively wide versus other asset classes. This attractiveness is mostly to be found in the weaker countries though. Little risk premium has been priced in for the other, more robust countries, for instance for the repercussions of the US elections in November. The downturn in (core) inflation has stalled somewhat but the Fed cutting interest rates will provide a boost. However, the interest compensation is relatively low versus developed countries, which reduces the relative attractiveness.	

Asset class	
Listed real estate	**Neutral**
The monthly movements of listed real estate continue to be largely dictated by movements in bond yields. The higher yields in the US and Europe therefore left their mark. Real estate noted bigger losses than general equities and the largest losses in several months following on from strong months from July to September. We hold a neutral outlook for this asset class. Valuations are relatively low versus general equities. Versus interest rates, listed real estate in global developed countries is expensive and European listed real estate has a neutral valuation in our opinion. Real estate faces higher interest rates on refinancing and tight lending conditions at banks. The marginally lower interest rates compared to the peak are easing things somewhat though. Transactions remain at low levels but have picked up somewhat recently. If the number of transactions normalises, this could create clarity on the value of the underlying properties.	
Commodities	**Neutral**
The Bloomberg general commodity index declined slightly in October. A further upturn in the price of gold and a small increase in the oil price were counterbalanced by lower prices for metals. Oil markets are tight and stocks low, but the knowledge that the OPEC countries have sufficient production capacity and are using it wisely restricts the upward potential for oil prices. The weakness in global industry and China is likewise squeezing oil prices. We see little upward potential for metals for the same reason. The gold price remains high. We think the gold price is mainly being shored by up by the gold purchases of central banks. It’s impossible to predict how long this will persist. 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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Disclaimer

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