FINALIZED JUNE 22TH, 2018

- A disastrous G7 summit
- Don't declare the end of easy money just yet
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- European shares are more defensive with their low leverage
- The spectre of the Euro-Area debt crisis still hangs over Italian bonds

Dear investor,

- **The uncertainty created by ongoing trade negotiations is bad for business** as the contagion effect of this uncertainty could be a more cautious approach to capital spending and business investment….
- … **but the market is able to shrug off trade or political headlines and volatility as long as corporate earnings stay strong and interest rates don't get too high**.
- We see **much better potential in smaller companies** that do business mostly in their home markets and are therefore less exposed to the geopolitical and trade risks pressuring others that rely more heavily on overseas markets.

Thierry Masset, Chief Investment Officer ING Belgium

EQUITIES

A disastrous G7 summit

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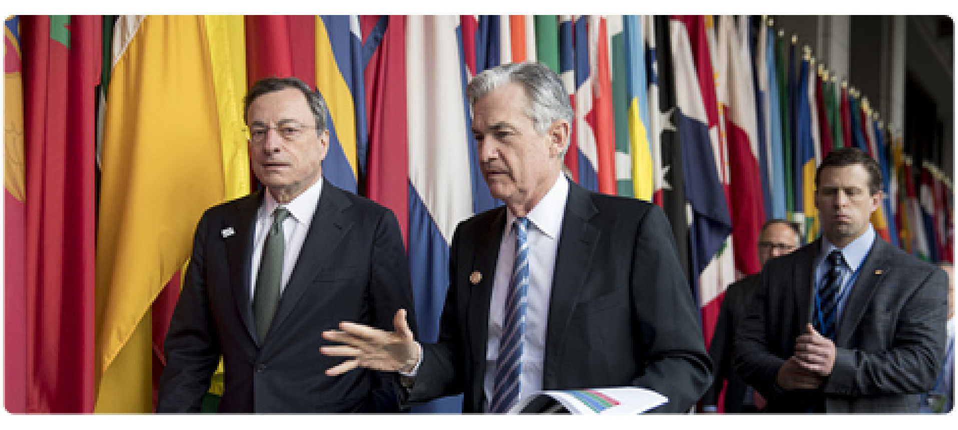
The market's ability to shrug off trade or political headlines and volatility is likely to continue as long as corporate earnings stay strong and interest rates don't get too high. This being said, the selloff in Emerging Markets (EM) shows few signs of abating as a combination of mounting trade-war concerns, a slightly hawkish Federal Reserve and the European Central Bank's decision to phase out asset purchases pummeled EM stocks and currencies.

Following the disastrous G7 summit last month, where President Donald Trump upended a carefully crafted effort at unity among the world's top economic powers, it is safe to say that most investors were probably expecting equities to stumble. Instead, the MSCI All-Country World index of global stocks closed near its highest level (in euro). A sign of complacency? Perhaps, but it must be acknowledged that the potential for a budding trade dispute to devolve in a legitimate trade war doesn't cause too much volatility. Although stock volatility surged in February and, to a lesser extent, in March and April, historically speaking, it wasn't all that extreme. In fact, world stock volatility still sits almost 40% below its average since 1998! It is true that the clouds on the horizon are getting darker. The mid-term elections in the U.S. are going to bring another bout of volatility. That is one cloud. The other cloud is trade and tariffs, and the third cloud is debt and deficits. Together, those clouds may keep a lid on things, while the synchronized global economic pickup is starting to sputter. But, even if the uncertainty created by ongoing negotiations is bad for business as the contagion effect of this uncertainty could be a more cautious approach to capital spending and business investment. It is reasonable to assume that markets will be to shrug off trade or political headlines and volatility, as long as corporate earnings stay strong and interest rates don't get too high. 2018 earnings projections for world stocks are hovering around the highest level since 2008 and let hope a strong earnings growth this year (+15%), while forward valuations have, at the same time, retreated 11% from a January peak. The forward price/earnings ratio (15.7) is now not far from the 20-year average (15.3).

BONDS

Don't declare the end of easy money just yet



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As central bankers have updated their plans to gradually "normalize" their monetary policy, which is code for raising interest rates and cutting back on their debt purchases, bond yields will go rising but not at an accelerating pace. This gradual approach adopted by central banks and the fragile state of trade talk or the constant threat of populism explain the quantitative easing measures are not as disruptive to bond markets as first feared. 10-year U.S. yields have retreated below the psychological 3% level.

Major central banks took significant steps last month toward dismantling the emergency stimulus they had used to lubricate financial markets and overcome the financial crisis. But most are clear that they are not ready to get out of the business of supporting their economies. The Federal Reserve (Fed) raised interest rates by 0.25% for the second time this year and the European Central Bank (ECB) announced it will phase out its €2.6 trillion bond-buying program by the end of this year. But, at the same time, Fed Chairman Jerome Powell tried to reassure investors that the central bank will stick with its "patient" plan to gradually normalize policy. And, in pursuit of the same goal, the ECB President Mario Draghi announced that the proceeds of maturing assets will be reinvested – meaning ECB is far from ready to follow the Fed in shrinking its balance sheet – and he will keep interest rates unchanged at record lows at least through mid-2019. Such commitments mean the loose-money era endures. Even if the combined balance sheet of the world's biggest central banks has decreased by 7% since a $11.4 trillion peak, it is still $7 trillion higher than when Lehman Brothers collapsed in September 2008. This gradual approach explains why efforts by the world's biggest central banks to unwind their quantitative easing measures are not as disrupting to markets as first feared. The Bloomberg Barclays World Sovereign Bonds index has gained 2% in euro (and lost 3.2% in local currencies) since the beginning of the year.

OTHER ASSET CLASSES

Commodities in tricky territory

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Commodities tend to perform well when an economic boom fuels inflation prospects and weakens U.S. dollar. The opposite seems taking place as intensifying Sino-U.S. trade friction raises concerns of disinflationary pressures just as the greenback powers higher. While it is too early to judge how profound the impact of trade tariffs will be, the uncertainty it will spread is a bearish signal that won't be easily shaken off even if the bullish outlook for demand remains intact.

No need to fear commodities anymore? Should there be a deep trade war, with ramifications for global growth, industrial commodities will be surely negatively affected. Besides steel and aluminum for which the Trump administration applied tariffs to imports, other raw materials, such as base metals and energy, are vulnerable to escalating trade war as impact of protectionist measures on global trade would dent economic prospects across the world and hurt cyclically exposed assets. Nevertheless, raw materials are until now supported by speculation that the bullish outlook for demand remains intact. Few weeks ago, the International Monetary Fund raised its forecast for global economic growth to 3.9% for 2018 and 2019. That would be the fastest rate since 2011, when the world was bouncing back from the financial crisis! Despite a decade of lackluster returns and bubbling trade tensions, the "strategic case" for buying commodities is still valid. Growing global demand compounded by shrinking inventories and a years-long underinvestment in new supplies is clearing the way for sustained high prices. As proof, commodities are the best performing asset class of 2018. They have returned 9% (in euro) this year, compared with 4.2% for equities and 2% for bonds.

IN THE NEWS

Non-democratic regimes account for a growing share of GDP

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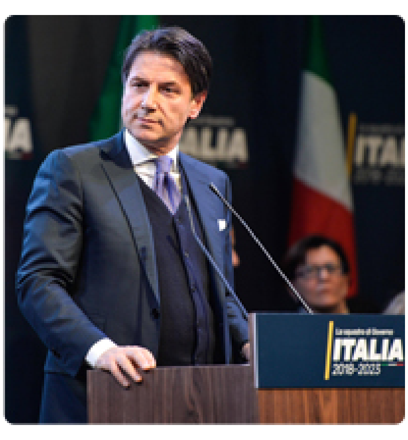
Call it the return of history. Looking at the Group of 20 major economies (G20), just 32% of gross domestic product (GDP) is under control of mainstream democratic parties, down from 83% in 2007, while the share controlled by populist and non-democratic regimes parties has risen to 65% from 12%. With economic logic playing a diminished role in guiding big policy decisions, it is reasonable to ask if this slide toward populism and authoritarianism and the accumulated pressure from protectionism, could mean a premature end to the growth story?

European shares are more defensive with their low leverage

Even after a decade of cheap rates, leverage in European companies is at the lowest since at least 2002 (3.3). This is an interesting observation as, in both the U.S. and Europe, highly leveraged companies have underperformed the least indebted ones significantly over the past year.

The spectre of the Euro-Area debt crisis still hangs over Italian bonds



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After months of political stalemate, the Five Star Movement and the League have formed a new government in Italy under the leadership of Giuseppe Conte. Needless to say that the new populist-led administration in the country that is responsible for almost one fifth of the euro zone's sovereign debt is hardly an investor's first choice.

More information isavailable from your ING contact person.

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