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Dear investor,

- You wouldn't be able to tell by looking at this year's equity rally and the collapse in volatility, but **investors are positioned for "secular stagnation"…**
- **... as they are chasing the equity rally by shifting toward less risky plays** such as defensive stocks, cash and bonds, and away from broader equities.
- That indicates a deep **lack of conviction in the sustainability of the rebound...**
- ... as the two main "tail risks" of **a trade war and a slowdown in China are keeping a lid on their growth expectations,…**
- **...even if global central banks' dovish turns have buoyed equity valuations.**

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Thierry Masset, Chief Investment Officer ING Belgium

EQUITIES

Tiger Woods and equities on the roof of the world

Has the equity rally gone too far? Investors are chasing the equity rally by snapping up defensive assets, a sign of the schizophrenia that has defined this year's bull run...

Watching Tiger Woods winning the Masters again or equities recording new peaks (in euro) can tell one thing: comebacks are possible. The MSCI World index (+17% since the beginning of the year), which includes both emerging and developed stock markets, has wiped out the losses recorded during the last quarter of 2018 and is now 2% above its 2018 highs. It is, to say the least, a decent performance, especially in a persistently uncertain and weak economic climate. Thanks to the surprise pliability of Federal Reserve Chairman Jerome Powell and his counterparts around the world, easing trade tensions and signs that China is bolstering its economy, the equation on stocks has changed for many investors. With the global economy widely forecast to decelerate, major central banks are having to delay their plans for "normalizing" monetary policy by withdrawing some of this excess liquidity, which means the party continues for risk assets. But it is worth noting that even if institutional investors boosted stocks this year, their global positioning relative to history remains defensive. They are clearly shifting toward less risky plays such as defensive stocks, cash and bonds, and away from broader equities as 66% of them (the highest since October 2016) expect a backdrop of low growth and inflation, according to the latest Bank of America Corp.'s monthly global fund managers' survey.
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- **Japan is the path Europe is headed toward.**
- **"Don't fight the White House" is U.S. market's mantra.**
- **Cyclical outperformance not matched by earnings.**

BONDS

There are risks to the Fed's "whites-of-the-eyes" approach in terms of inflation

Fed's change in tactics – Jerome Powell and his colleagues have put policy on hold until sub-par inflation rises convincingly – has potentially major ramifications for bond markets. With yields sinking across the globe, investors now face a dilemma. Buying government bonds at these levels is perilous because economic data may improve, while taking more risk with corporate debts leave investors nastily exposed to a global downturn.

Central banks are under pressure to rethink their monetary strategy. A slowdown in the world economy, the trade war and other geopolitical uncertainties are forcing policy makers to express caution about their scope for tightening monetary policy. The last example to date is the Federal Reserve (Fed) Chairman Jerome Powell who has backed off the steady march of quarterly rate increases he had been delivering to avoid a potentially dangerous rise in inflation that economic theory says could result from the hot jobs market. Instead, Powell and his colleagues have put policy on hold until sub-par inflation rises convincingly. Chicago Fed President Charles Evans even said that the central bank may hold policy steady until the fall of 2020 and might even reduce rates in the unlikely event that underlying inflation softened. But there are risks to the Fed's evolving approach. A policy that keeps rates lower for longer could spawn speculative risk asset bubbles and excessive leverage as investors are forced to take on more risk to earn returns they have become accustomed to. As bond traders are pricing in much less U.S. tightening than before they face increasing pressure to reprise the yield-chasing mentality. This obviously tempts those investors holding cash to move down the rating curve to seek yield. For proof, the market value of the world's investment-grade and high-yield bonds has jumped by almost $2 trillion since the end of last year to new record highs ($55 trillion).
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- **Market "madness" sees Greek bond yields fall below U.S.**

OTHER ASSET CLASSES

Oil is in the midst of an epic rally

As Washington won't renew exemptions from U.S. sanctions for buyer of Iranian crude after the waivers expire on May 2, oil quickly repriced higher on fear that markets could face an immediate supply crunch.

Crude oil prices surged 45% in the U.S. (WTI) and 38% in Europe (Brent) since the beginning of the year, for their best performance in a decade, notably as the U.S. said it will no longer give any buyer of Iranian crude a waiver from sanctions aimed at cutting the Organization of Petroleum Exporting Countries (OPEC) producer's exports to zero. In response, Iran threatened to shut the Strait of Hormuz, a key maritime chokepoint for Persian Gulf producers. As the White House's decision to end exemptions - issued to China, Greece, India, Italy, Japan, South Korea, Taiwan and Turkey - on May 2 for purchasing oil from the OPEC's fourth largest producer supports the bull case for oil, oil quickly repriced higher on fear that markets could face an immediate supply crunch. Nevertheless, we must not forget that the U.S. decision may also jeopardize the deal that the OPEC and its partners reached to limit output until end of June - they agreed in December to remove 1.2 million barrels a day from the market. Saudi Arabia and the United Arab Emirates can easily offset any drop from Iran's crude and ensure the oil market does not go out of balance. If they boost their output, it will have hard time persuading others OPEC members to limit their own production and that should weigh on oil prices… Read More

- **Commodities' best start since 2016 may be tough act to follow.**

IN THE NEWS

Brexit to China: mapping trade risk exposure

Brexit (delayed to Halloween), the U.S. – China dispute, and the possibility of U.S. auto tariffs mean the world economy faces substantial threats to free trade. Bloomberg calculates that some 2.3% of global GDP is tied to trade flows that are at risk from greater protectionism. That means tariffs would slow the activity, not wipe it out.

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How much of world economy is run by populists?

Based on Bloomberg classification, 43% of G-20 GDP is under the governance of populist rulers. That is up from 8% in 2016. If global growth falls more sharply than we anticipate – our economists puts world growth at 3.4% in 2019 and 2020, versus 3.8% in 2018 – , antagonistic and inward-looking leaders of major economies will be ill-placed to coordinate a response.

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High risk is not the answer to negative yields

While the amount of debt with negative yields has grown about $10 trillion, a level last seen in 2016, bond investors face a classic late-cycle conundrum of deciding whether it is worth it to buy lower-rated debt to capture yield.

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If you have any questions or wish to discuss this further, please contact your private banker.

