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- Ultra-low rates are no panacea for stocks
- Back to quantitative easing
- Saudi attacks reveal oil supply fragility
- Less risk = more return
- Low rates caused by political uncertainty
- Gold miners: M&A can trigger a game of musical chairs

Dear investor,

- **The European Central Bank acted to reflate its economy, following the lead of the Federal Reserve and other counterparts in injecting fresh monetary stimulus.** President Mario Draghi cut interest rates and resumed bond buying as global demand is being undermined by the U.S.-China trade war.
- **Unfortunately, the interest rate cut and other measures Mario Draghi announced are unlikely to do the job.** Instead, they are a reminder that monetary policy has probably reached its limits. This puts the onus on political leaders to do their part, with a big and quick fiscal stimulus. All the ECB might be able to do is make the funding of such projects as cheap as possible.
- **The rotation into cyclical shares and high-beta strategies observed last month is unlikely to last structurally if growth stays weak...**
- **... and if the geopolitical context remains strained, especially in the Middle East.**

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EQUITIES

Ultra-low rates are no panacea for stocks

As long as rates stay low, geopolitical tensions are not resolved and markets fear a recession, equity investors are likely to continue to favor low-volatility stocks.

The S&P 500 index is up 20% for the year. This is a remarkable achievement, given that earnings growth has stalled and the bond market is pricing in almost a 40% chance of a recession over the next 12 months. That just shows the degree to which lower interest rates have supported stocks. And yet, as is often the case in life, too much of a good thing isn't always, well, good. This year's rally - during which the S&P 500's forward price-to-earnings multiple expanded to 17.6 from 14.5 at the start of January - can be credited to the Federal Reserve's dovish pivot, which led to the central bank's first rates cut since 2008 and sparked big declines in market rates. Simple discounted cash-flow analysis shows how lower rates make future earnings more valuable now, justifying higher multiples for equities even without profit growth. So, logic would dictate that the lower rates go, the better for equities. But the experience in Europe shows that there comes a point where ever lower rates begin to work against stocks. Even though 10-year bond yields in Germany have fallen below zero, stocks there only trade at a multiple of about 14 times earnings. That is little changed from mid-2014, when yields were around 1.25% and the European Central Bank cut its benchmark deposit rate to below zero. With earnings estimates coming down and price-to-earnings ratios on the high side, it won't be easy for stocks to keep marching higher even if the Fed does continue to slash rates...
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- **Don't get excited by the rebound in Emerging Market stocks**
- **The sell-off in defensive stocks can be temporary**
- **Bigger is better in stocks**

BONDS

Back to quantitative easing


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The slow-but-steady economic growth since the financial crisis, combined with ever-accommodating central banks, has made reaching for yield the obvious trade for fixed-income investors. In this environment, we keep our preference for Emerging Market debt and Investment Grade bonds.

July and August's rally in sovereign bonds was arguably the broadest this decade. Thanks to relentless quantitative easing and a global wave of rate cuts - markets, which are nervous because of the deteriorating global economic outlook, expect central banks to go on a loosening tear, cutting more than 10% in interest rates worldwide over the next year -, yields on sovereign bonds fell across all 24 developed markets to record lows (0.65% on average). The rally seems fair, given severe uncertainty over trade that is dragging down global growth and heightening the risk that businesses will put off investment. But the rally is also starting to look overextended, raising the prospects for a pullback. And that is precisely what happened last month. For instance, the 30-year Treasury yield, which sank to an all-time low of 1.90% in late August from above 2.5% at the end of July, is now back up to about 2.30%. But as both the European Central Bank and the Federal Reserve, fearing market disruptions and a spike in volatility, have taken more stimulus measures, bond yields should stay structurally low.
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- **Investment Grade bonds seem to become the new stocks**
- **Bond yields will stay within a relatively narrow range**

OTHER ASSET CLASSES

Saudi attacks reveal oil supply fragility


Belgaimage

The vulnerability of Saudi infrastructure, historically seen as a stable source of crude to the market, is a new paradigm the market will need to deal with and haven assets, such as gold, will continue to be supported on concern over the geopolitical fallout from the attacks.

Commodities get suddenly more expensive. The S&P and Goldman Sachs Commodity index increased by 16% (in euro) since the beginning of August, thanks essentially to energy (+27%) and precious metals (+7%). They both rallied after the strike against oil facilities in Saudi Arabia, which knocked out about 5% of world oil supplies. For decades, Saudi Arabia has been the oil market's great stabilizer, maintaining a large cushion of spare production capacity that can be tapped in emergencies, such as the 2011 war in Libya. The halt of 5.7 million barrels day of the kingdom's production - the worst sudden supply loss in history - exposes the inadequacy of the rest of the world's supply buffer. In addition to the immediate loss of supply, the attack raised the specter of U.S. retaliation against Iran, which could further inflame oil prices. No matter whether it takes Saudi Arabia few weeks or a lot longer to get oil back into production, there is but one rational takeaway from this drone attacks on the Kingdom's infrastructure: that infrastructure is highly vulnerable to attack, and the market has been persistently mispricing oil. Even if crude prices will probably remain elevated as traders factor in higher risks for Saudi supply, the fallout from the Saudi attack should to be manageable. It would take months for Saudi Arabia's full outage to deplete existing OECD industry crude stockpiles of about 1.1 billion barrels.
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- **Gold ETFs surge more than 270 tons as havens in vogue**
- **Saudi attack tops biggest oil disruptions in history**
- **Nickel rallies as Indonesian ban sends shockwaves through market**

IN THE NEWS

Less risk = more return

There is a relationship between risk and return, but that relationship runs in exactly the opposite direction to the way that we had all supposed. As academics sift through the data for persistent anomalies that can predict which stocks will perform best, the clearest is that lower risk stocks tend to outperform in the long run. During the last two decades, the MSCI US minimum volatility index has outperformed by 260% (in euro) the S&P 500 index.

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Low rates caused by political uncertainty


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While low interest rates in the early part of this decade were caused by economic pessimism - high unemployment and excess debt in the wake of the great recession - low interest rates today could be more reflective of political uncertainty and pessimism.

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Gold miners: M&A can trigger a game of musical chairs

There is a natural tendency for gold miners to consolidate, as most of them failed to invest for the future by expanding their mining activities and as companies need to be larger to stay relevant to a shrinking pool of investors.

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

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