

Cloudier outlook

June 2019

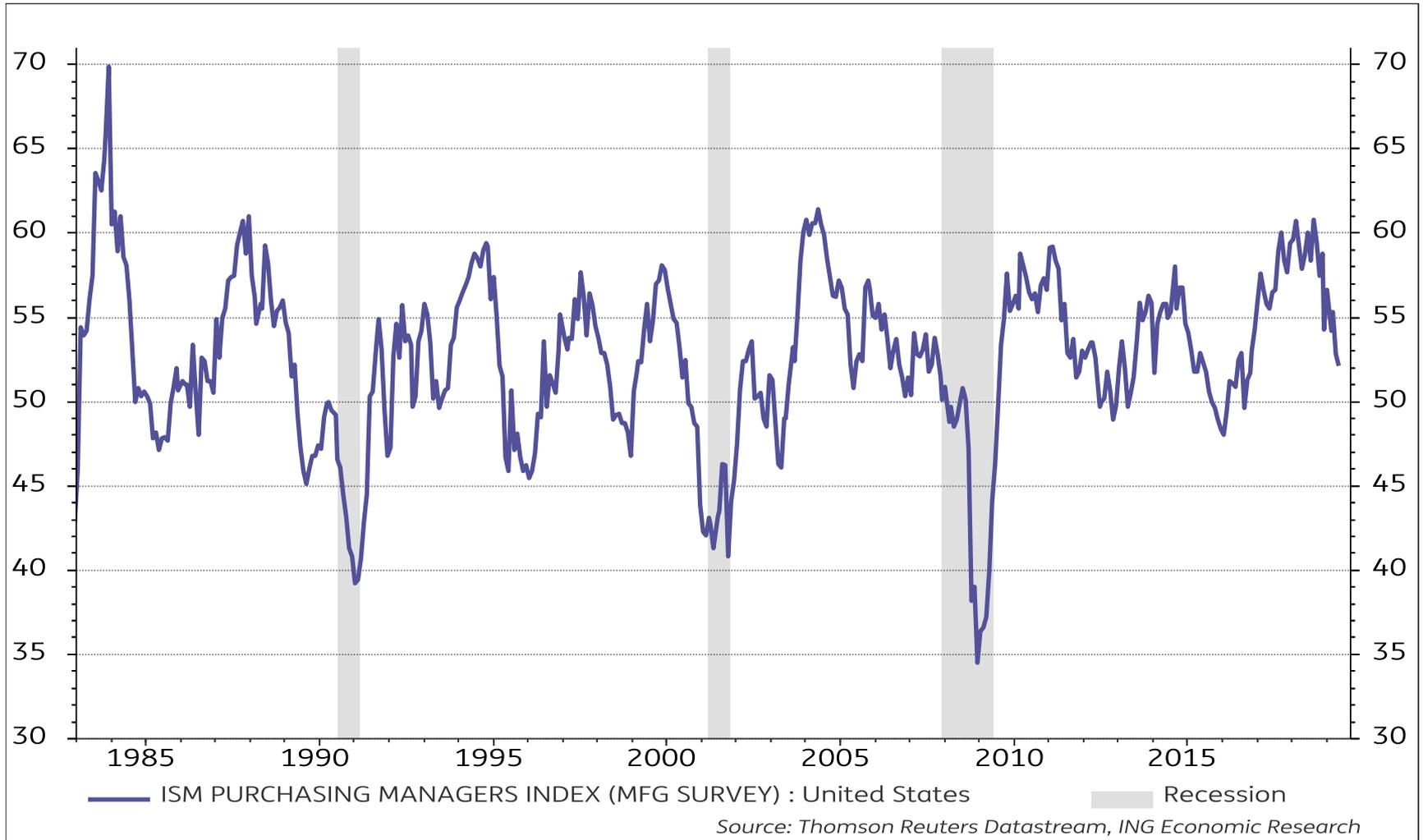
Peter Vanden Houte
Chief Economist ING Belgium



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Can the long expansion last?



Expansions don't die of old age (Yellen). Or do they?

Recent research refutes the view that age doesn't matter for expansions

- Up to 8 quarters, the risk of recession increases with duration, reflecting the possible occurrence of double-dip recessions.
- Then from 8 to 25 quarters, the probability of entering a recession appears to decrease as the expansion ages (the expansion becomes self-sustaining)
- Once an expansion > 25 quarters, certain vulnerabilities may arise that make the onset of a recession more likely.

Probability of a recession in the next 2 years	
<u>Length expansion in quarters</u>	<u>Probability of recession in %</u>
10	31
20	42
30	50
40	57



Source: Beaudry and Portier (2019)

Trump's success with Mexico, could make him tougher on the other trade partners



Donald J. Trump  @realDonaldTrump · May 14

When the time is right we will make a deal with China. My respect and friendship with President Xi is unlimited but, as I have told him many times before, this must be a great deal for the United States or it just doesn't make any sense. We have to be allowed to make up some....



Donald J. Trump  @realDonaldTrump · May 31

Mexico has taken advantage of the United States for decades. Because of the Dems, our Immigration Laws are BAD. Mexico makes a FORTUNE from the U.S., have for decades, they can easily fix this problem. Time for them to finally do what must be done!

 16K  22K  91K 

 Donald J. Trump Retweeted

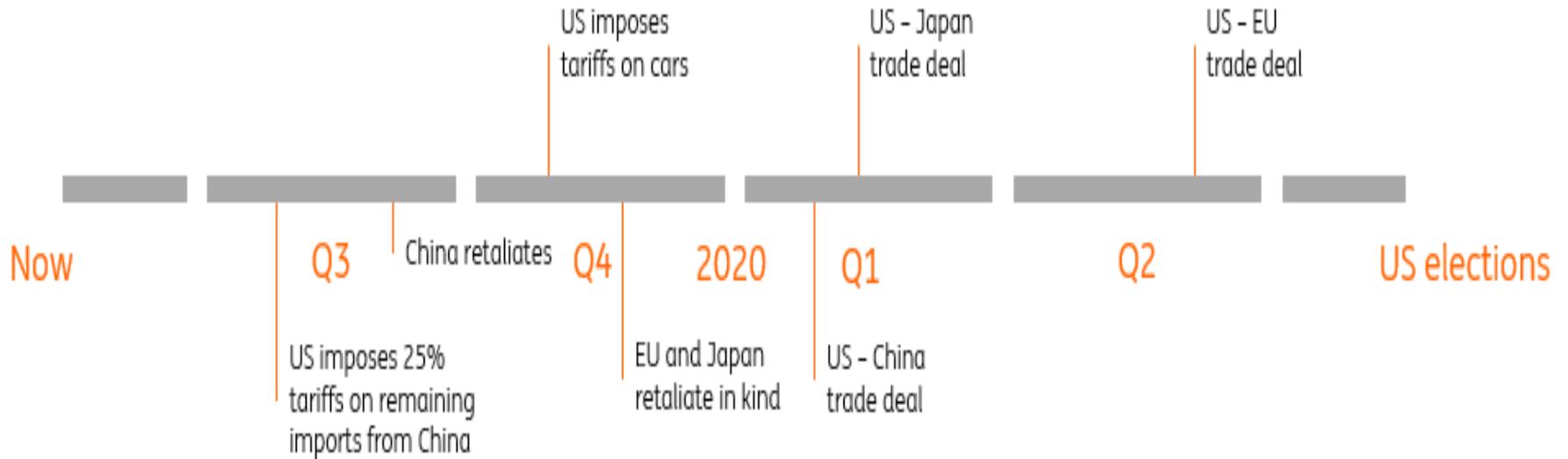


Donald J. Trump  @realDonaldTrump · Jun 7

I am pleased to inform you that The United States of America has reached a signed agreement with Mexico. The Tariffs scheduled to be implemented by the U.S. on Monday, against Mexico, are hereby indefinitely suspended. Mexico, in turn, has agreed to take strong measures to....

 31K  56K  238K 

World trade will suffer this year

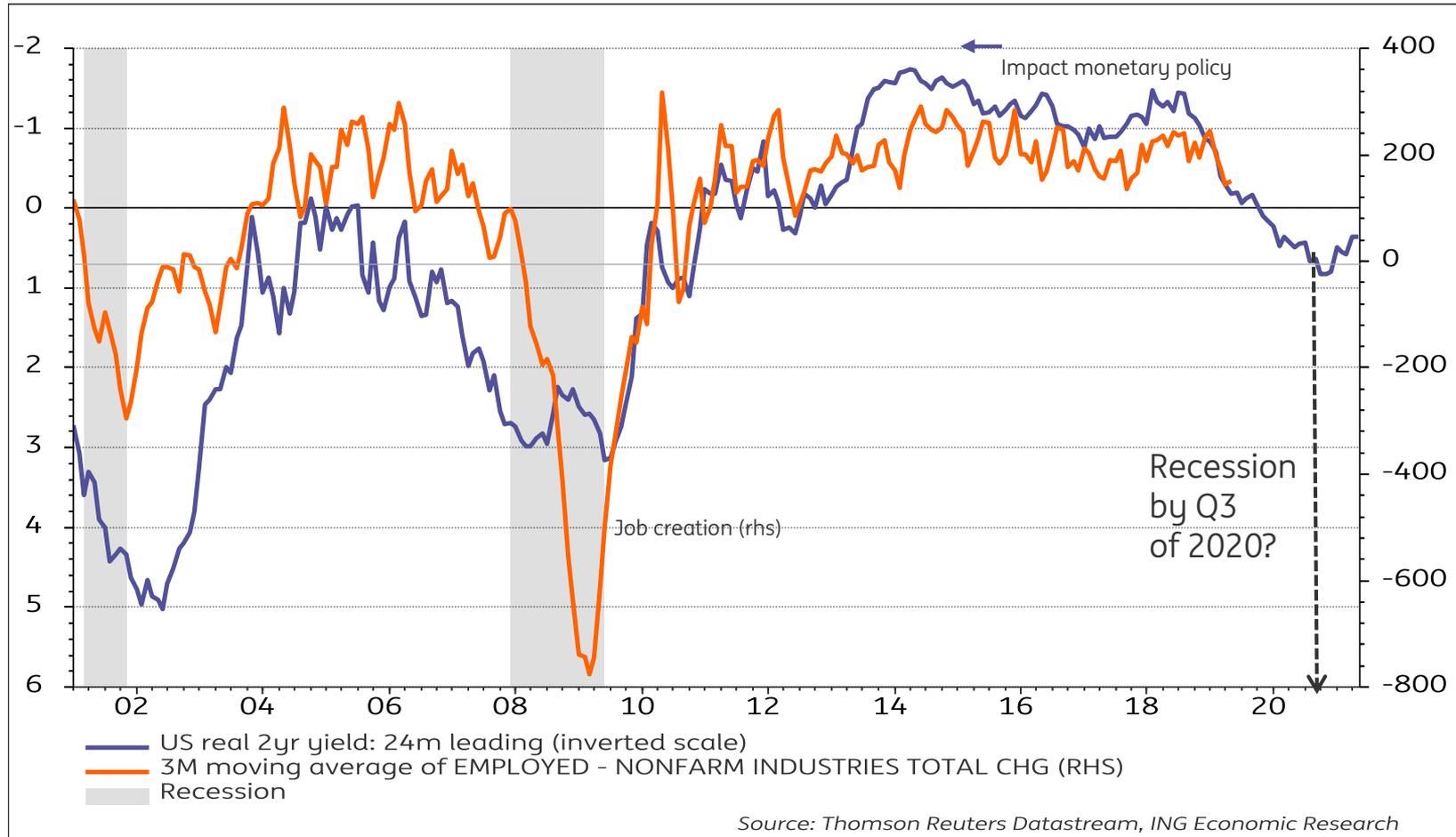


	2019	2020
Trade war effect on international trade	-0.8%	+0.5%
Growth international trade	0.4%	2.2%

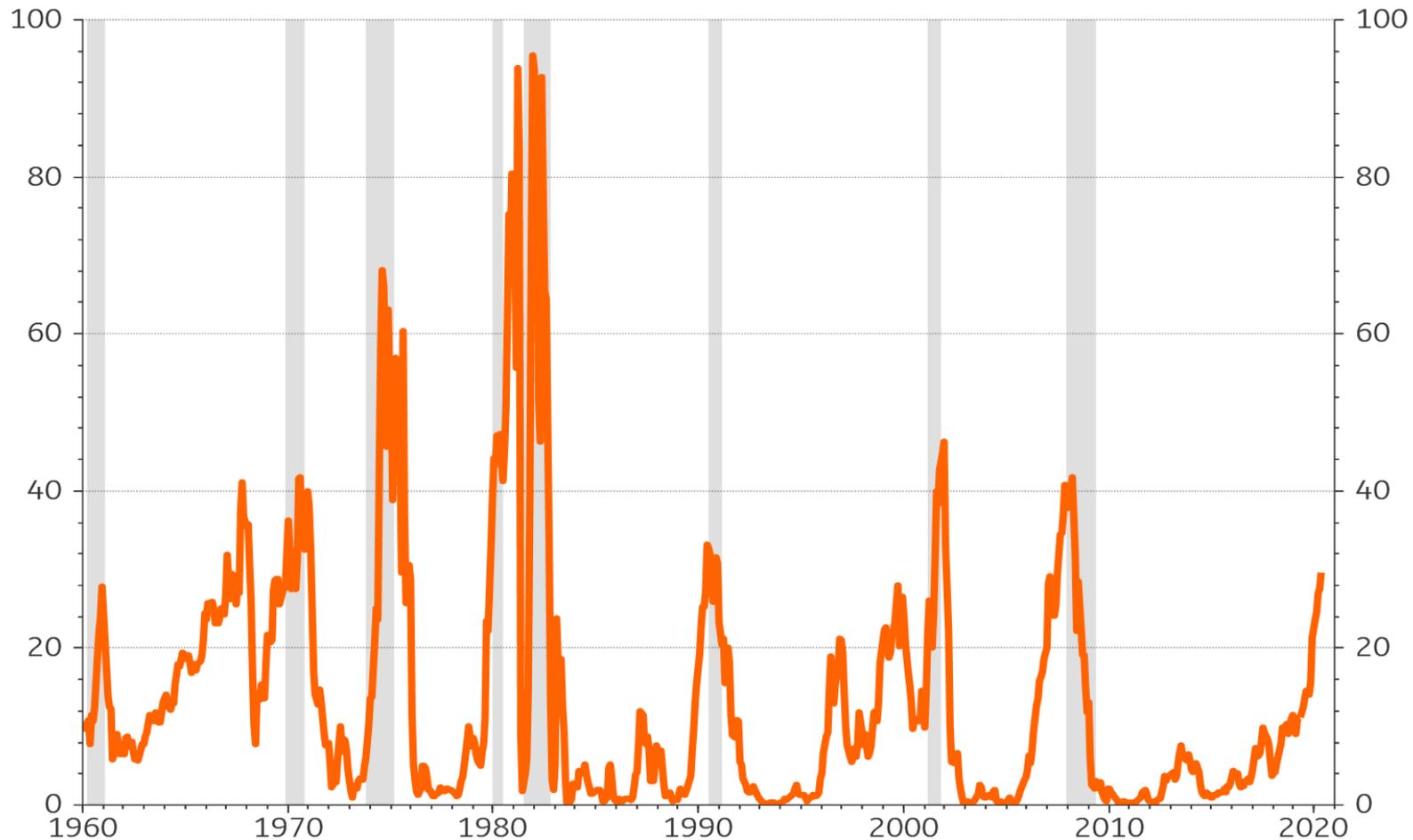
(Added value car exports from Belgium to the US = 0.1% of GDP)

Source: ING

US economy could see stronger slowdown in 2020

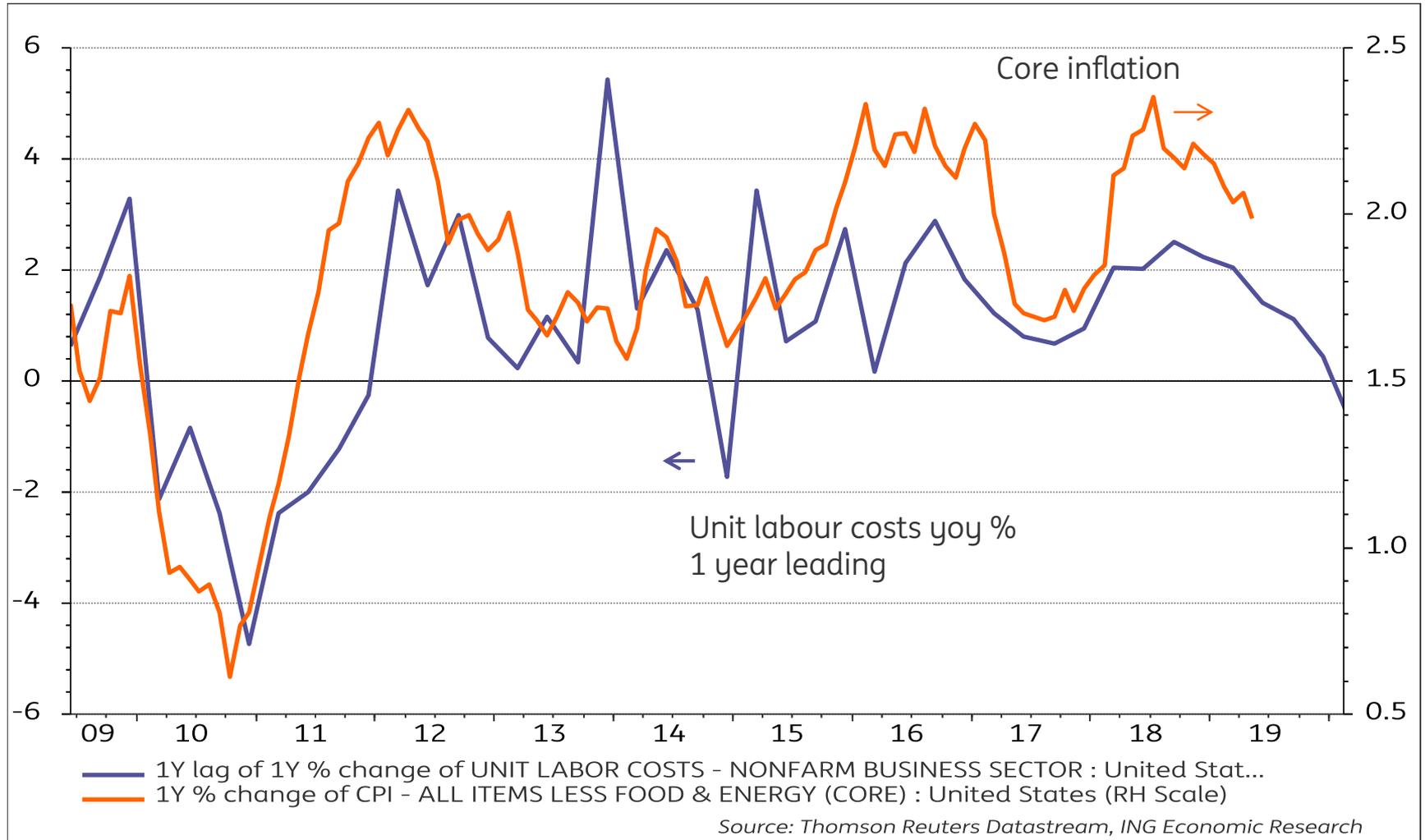


New-York Fed: probability of a recession

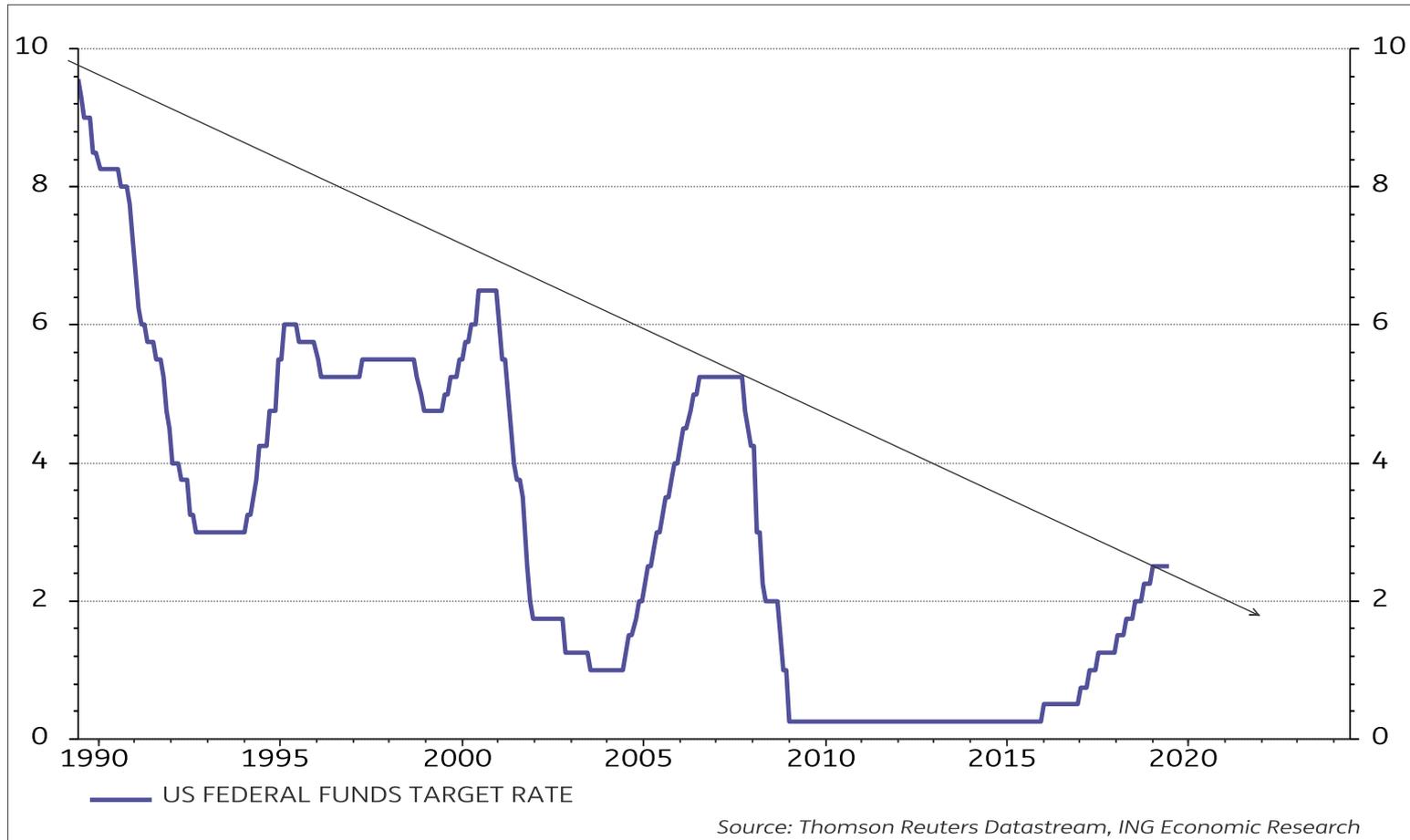


Source: Thomson Reuters Datastream, ING Investment Office

Inflationary pressures remain muted in the US



Fed funds target rate since 1989

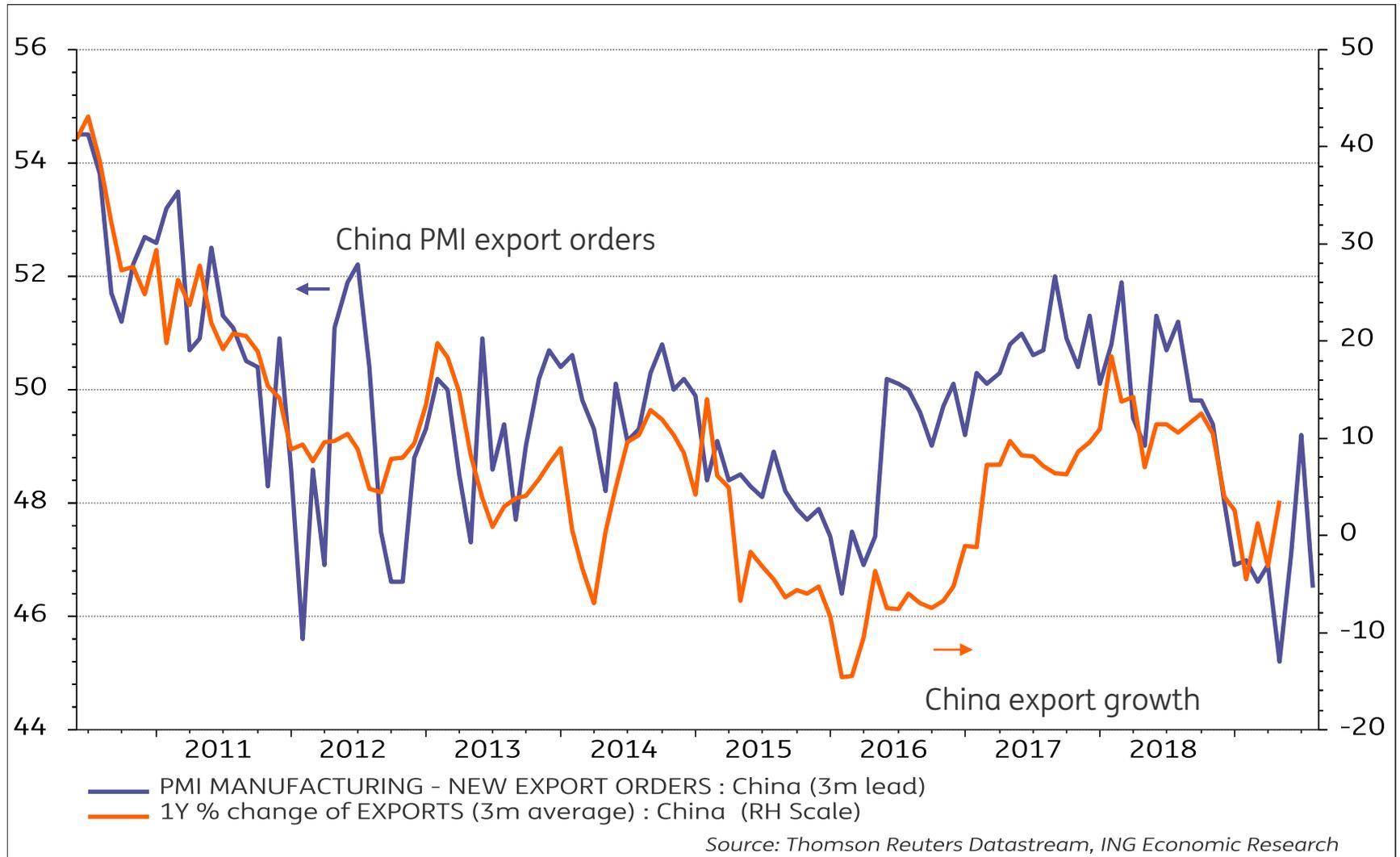


2 rate cuts now seem likely this year

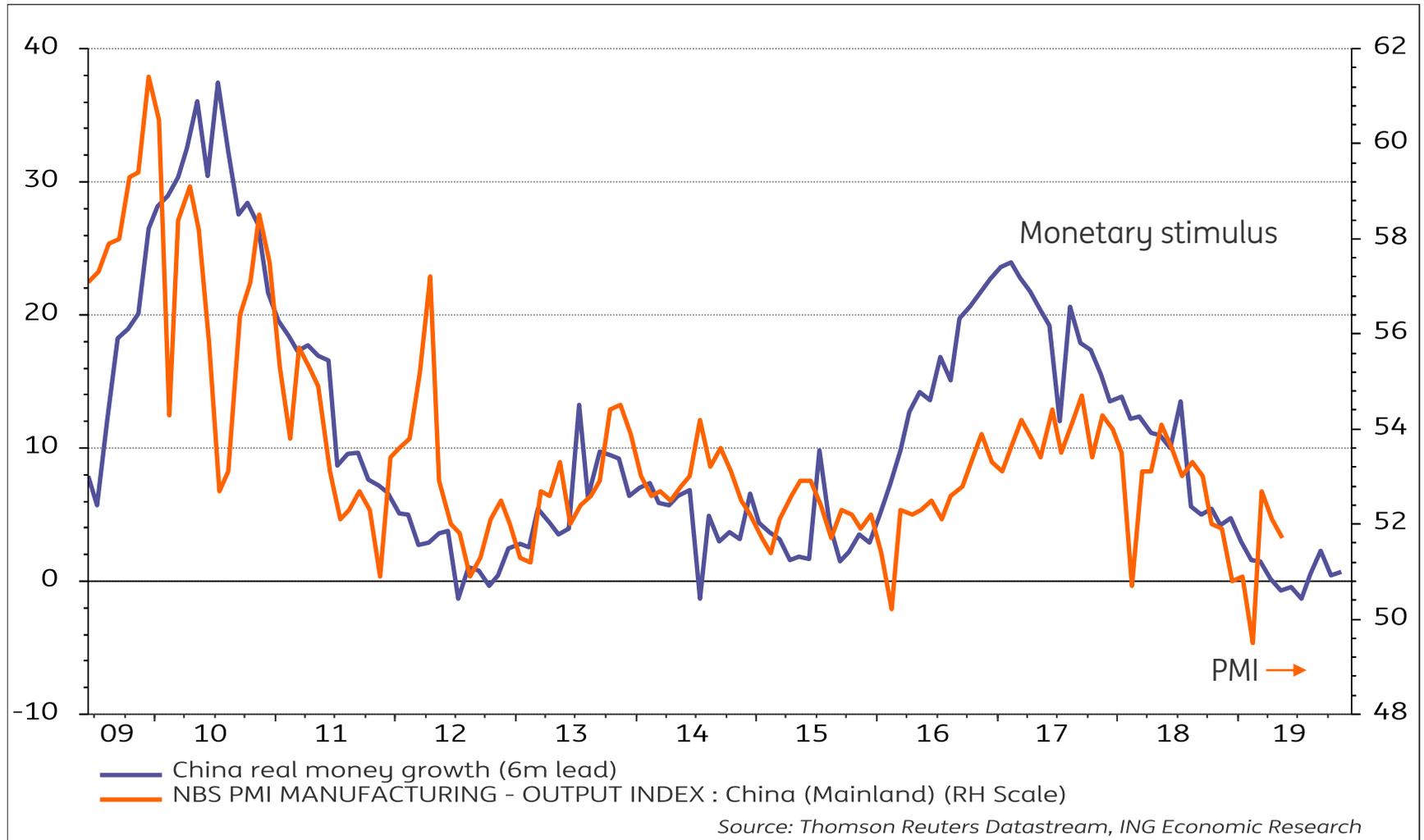
China: some signs of stabilisation



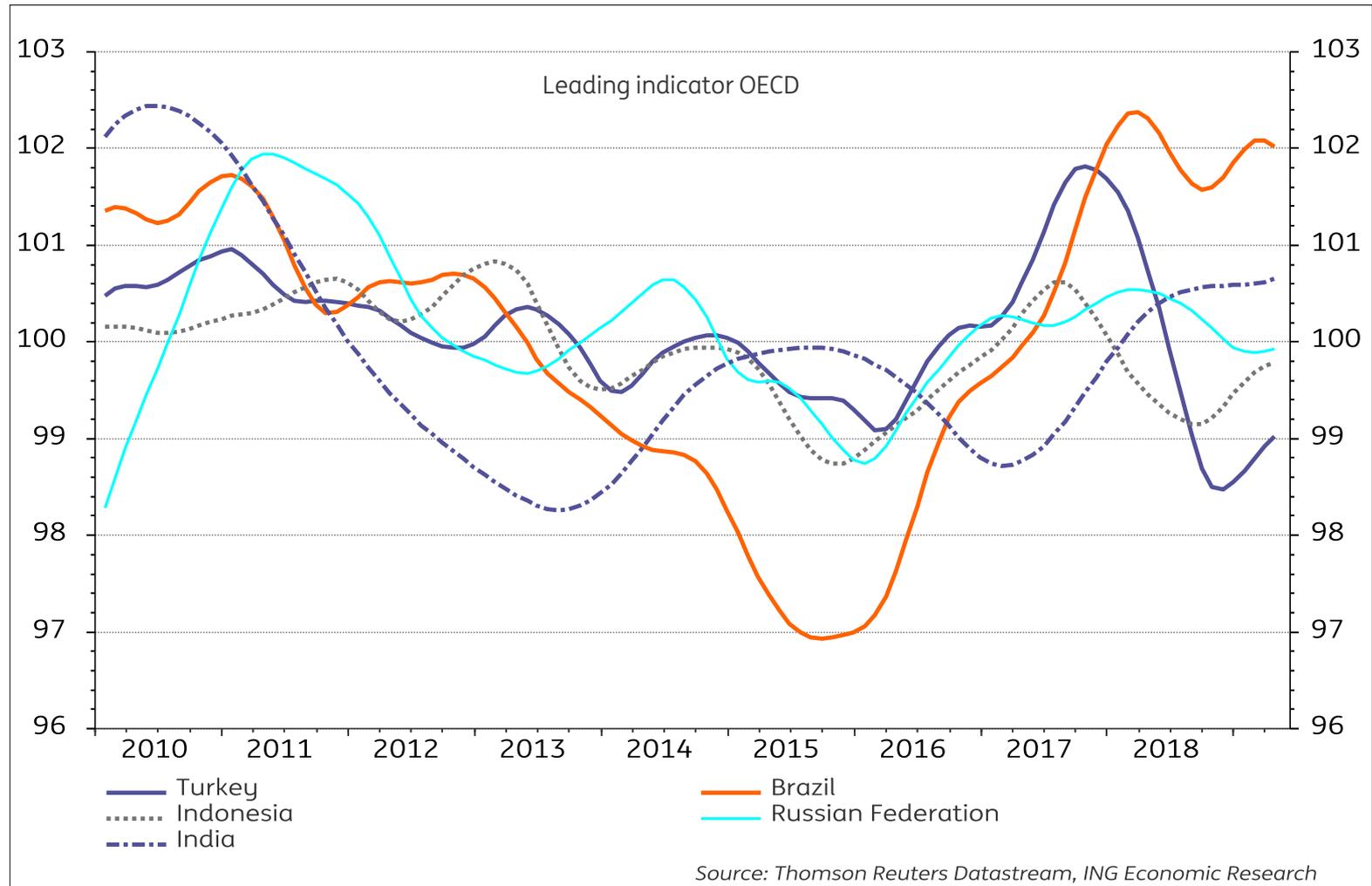
Impact trade war on Chinese exports



More Chinese stimulus needed?



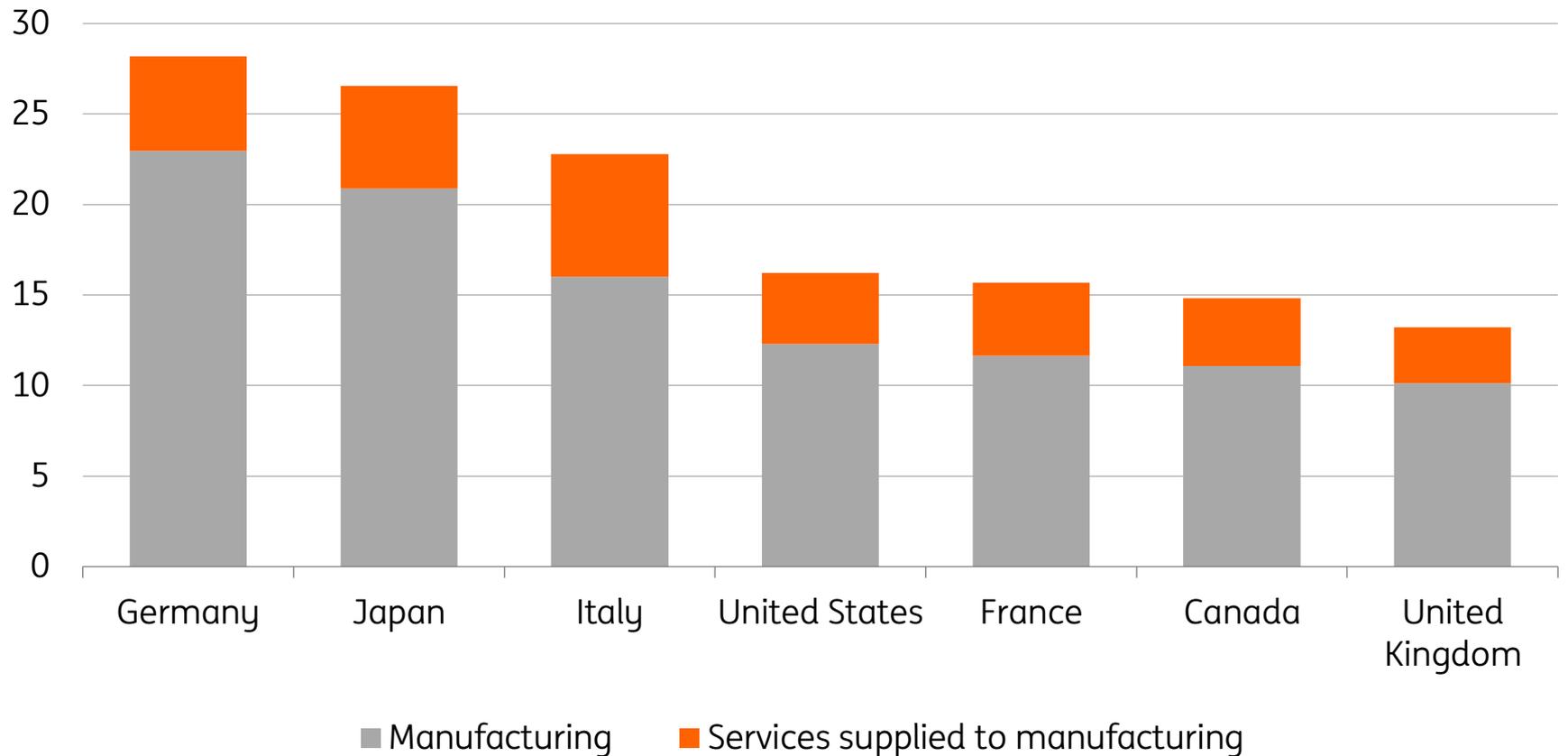
Temporary (?) improving picture in emerging world



European growth slows to cruising speed



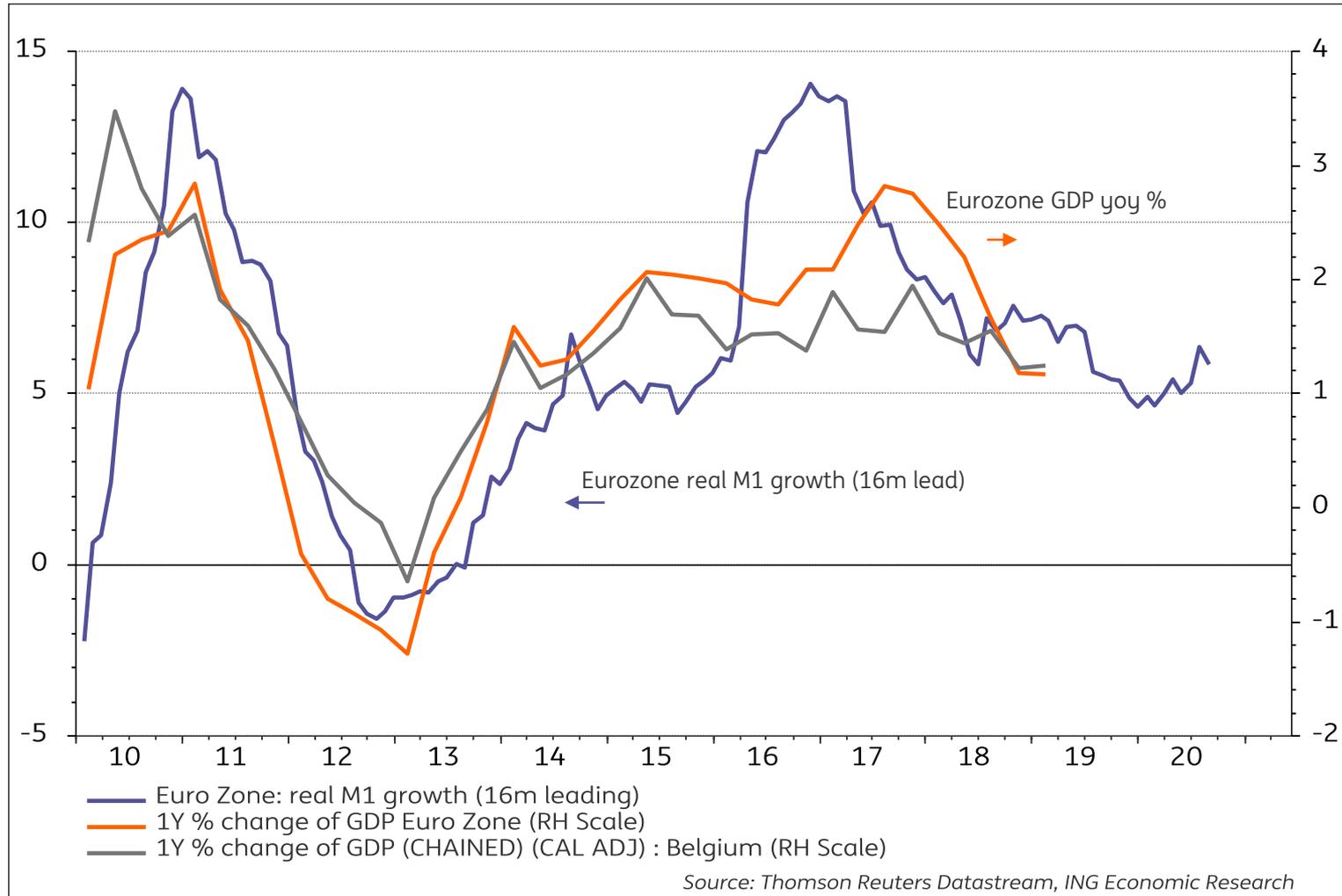
Share of manufacturing and related services in GDP



For Belgium the sum of both is around 20%

Source: OECD

Leading indicators suggest some growth deceleration in Europe, but no recession (yet)



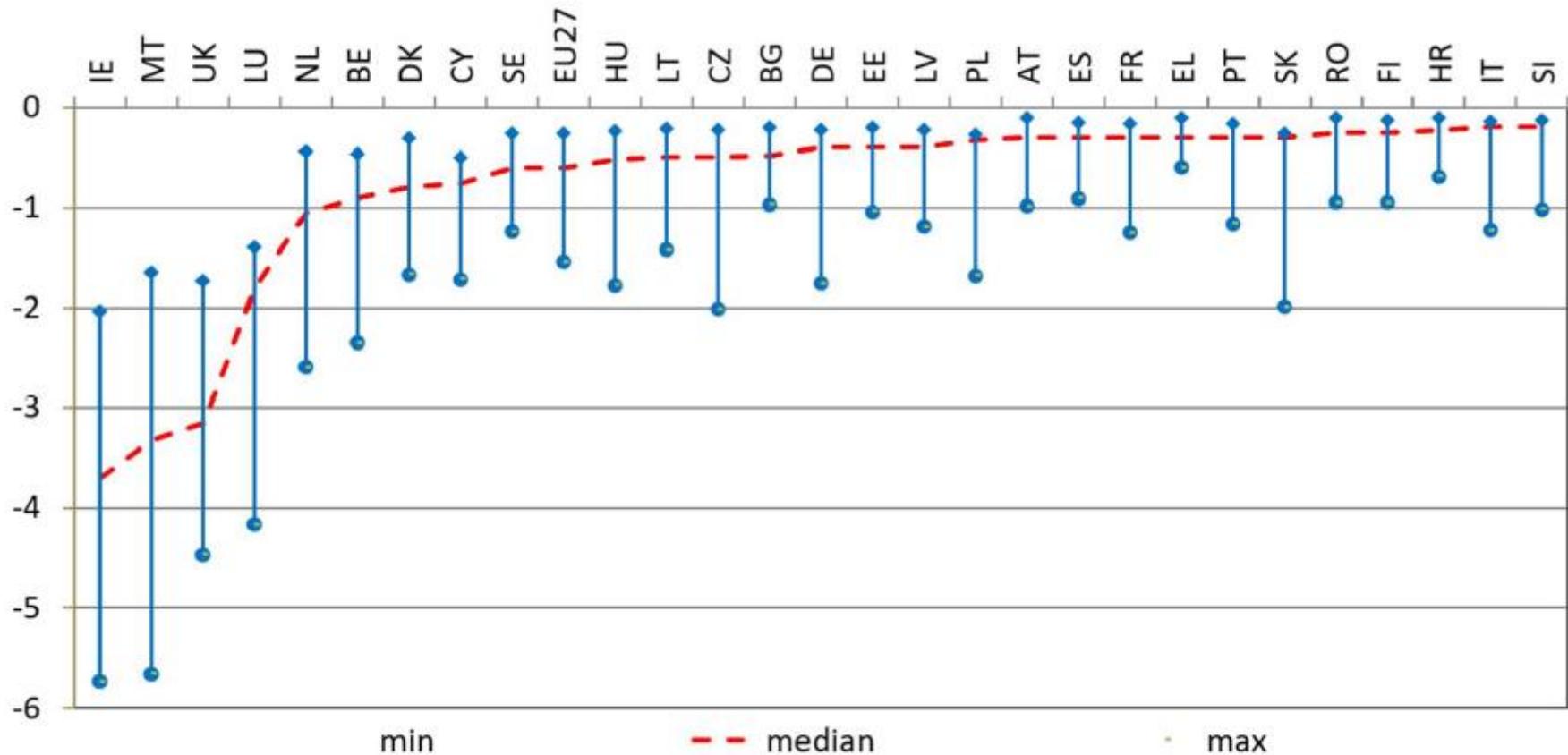
Brexit uncertainty



- Bookmakers give:
- 30% probability of a hard Brexit in 2019
 - 26% probability of Article 50 revoked
 - 71% probability of Brexit date delayed further
 - 30% probability of general elections in 2019

For Belgium, exports to the UK dropping by 10%, would shave off 0.3% of GDP

Potential GDP impact of no deal Brexit



Source:NBB, based on several studies

Italian crisis is flaring up again



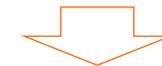
- European Commission recommended Excessive Deficit Procedure against Italy
- Ecofin will have to decide on this on the 9th of July
- Salvini & Di Maio want tax cuts and the abolishment of the planned VAT increase in 2020



Tensions between Italy and EC

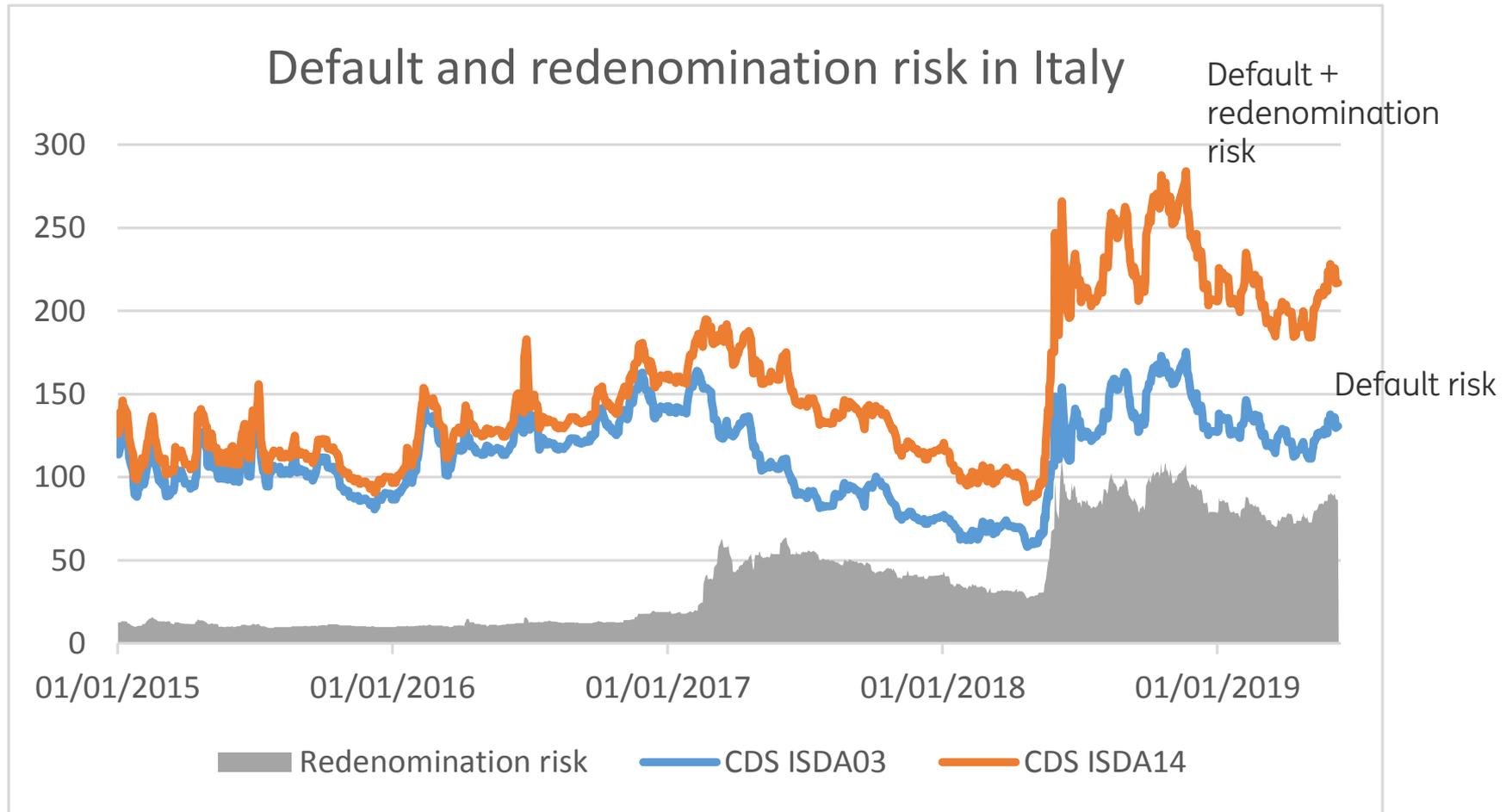


Italian Government falls. Salvini has an interest to capitalize on his strong European election result



General elections in September?

Markets start to worry again about Italy

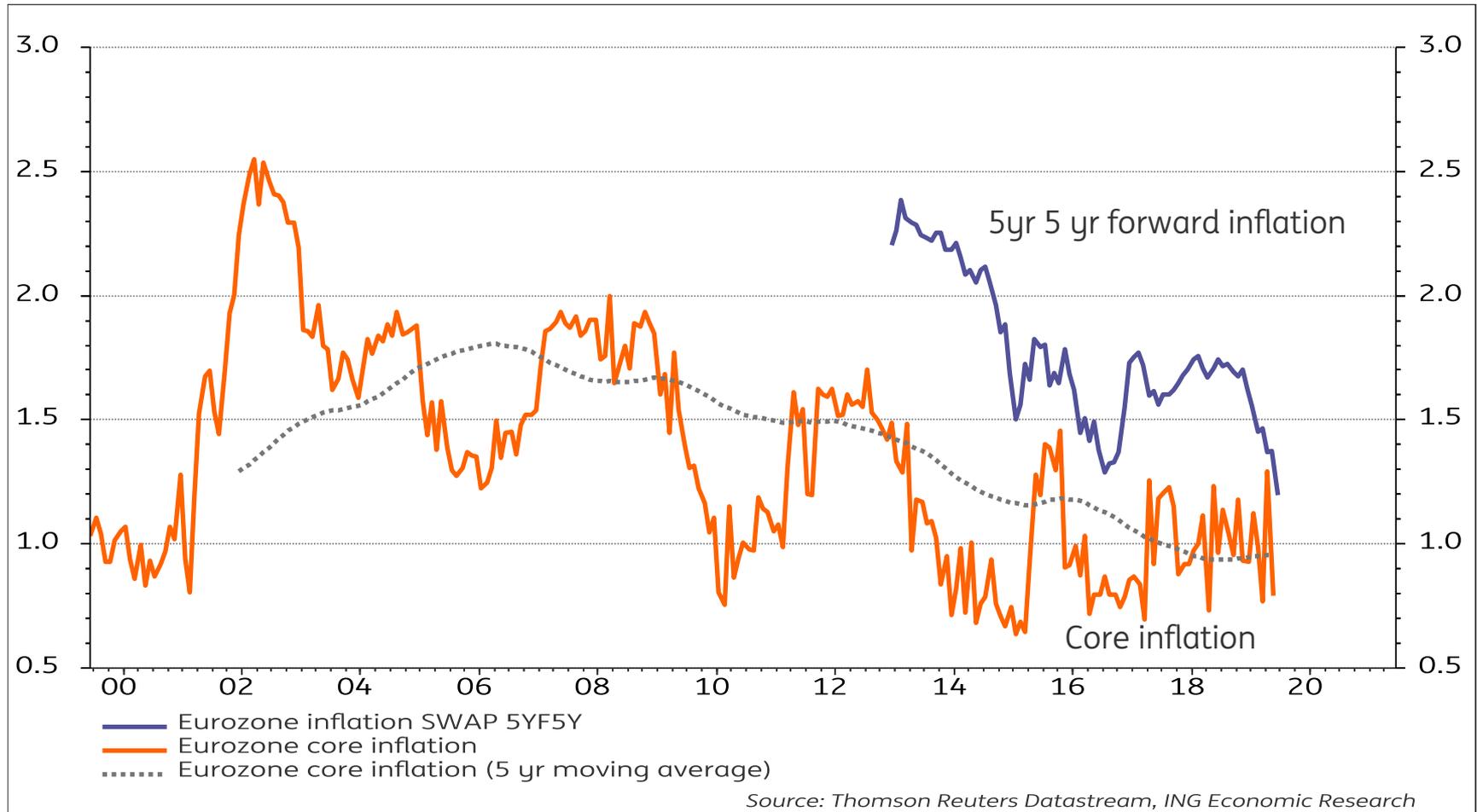


Growth expectations

	2017	2018	2019	2020
USA	2.2	2.9	2.5	1.8
Eurozone	2.5	1.8	1.0	1.0
UK	1.7	1.3	1.3	1.2
Belgium	1.8	1.5	1.0	1.0
Japan	1.7	0.8	0.9	0.6
China	6.9	6.6	6.3	6.2

- Potential wild card:
- Germany has 4 additional working days in 2020
 - Belgium has 3 additional working days in 2020
 - France and Italy have 2 additional working days in 2020

Inflation is still going nowhere in the Eurozone



Over the last 5 years both headline and core inflation have been on average below 1% !

What are the options left for the ECB?



- Cut rates?

- a 10 Bp rate cut looks likely (but will probably have to be supplemented with a tiering system for excess liquidity to limit negative side-effect on banking sector)
- Reduce the rates on TLTROs might still be possible

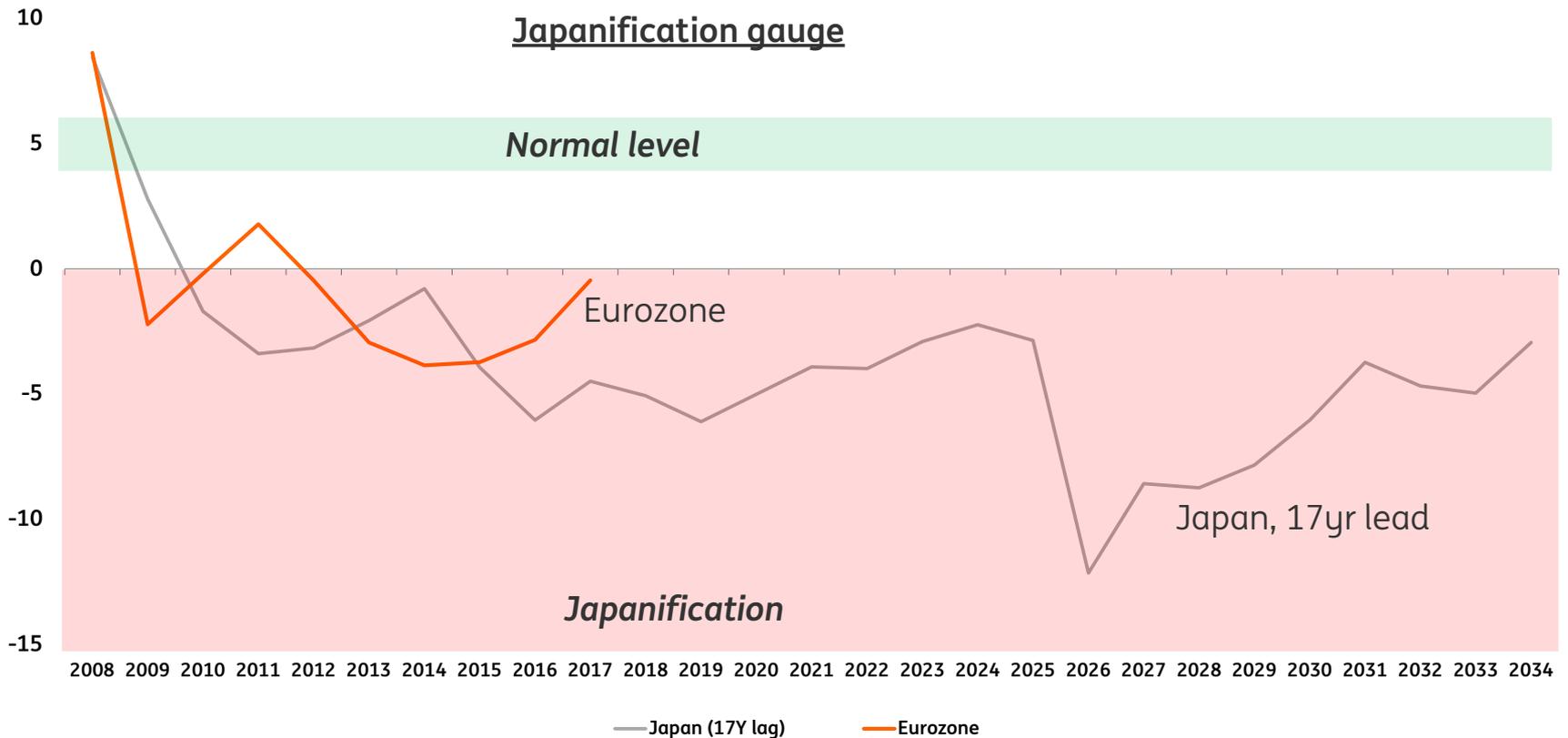
- More QE?

- Sovereigns bonds: difficult, because already close to 33% threshold (going above would create constitutional problems)
- Corporate bonds: possible
- Bank bonds: could be added
- Stock market: last resort (creates distributional issues)

Turning Japanese?



The Japanese disease: Eurozone is getting infected



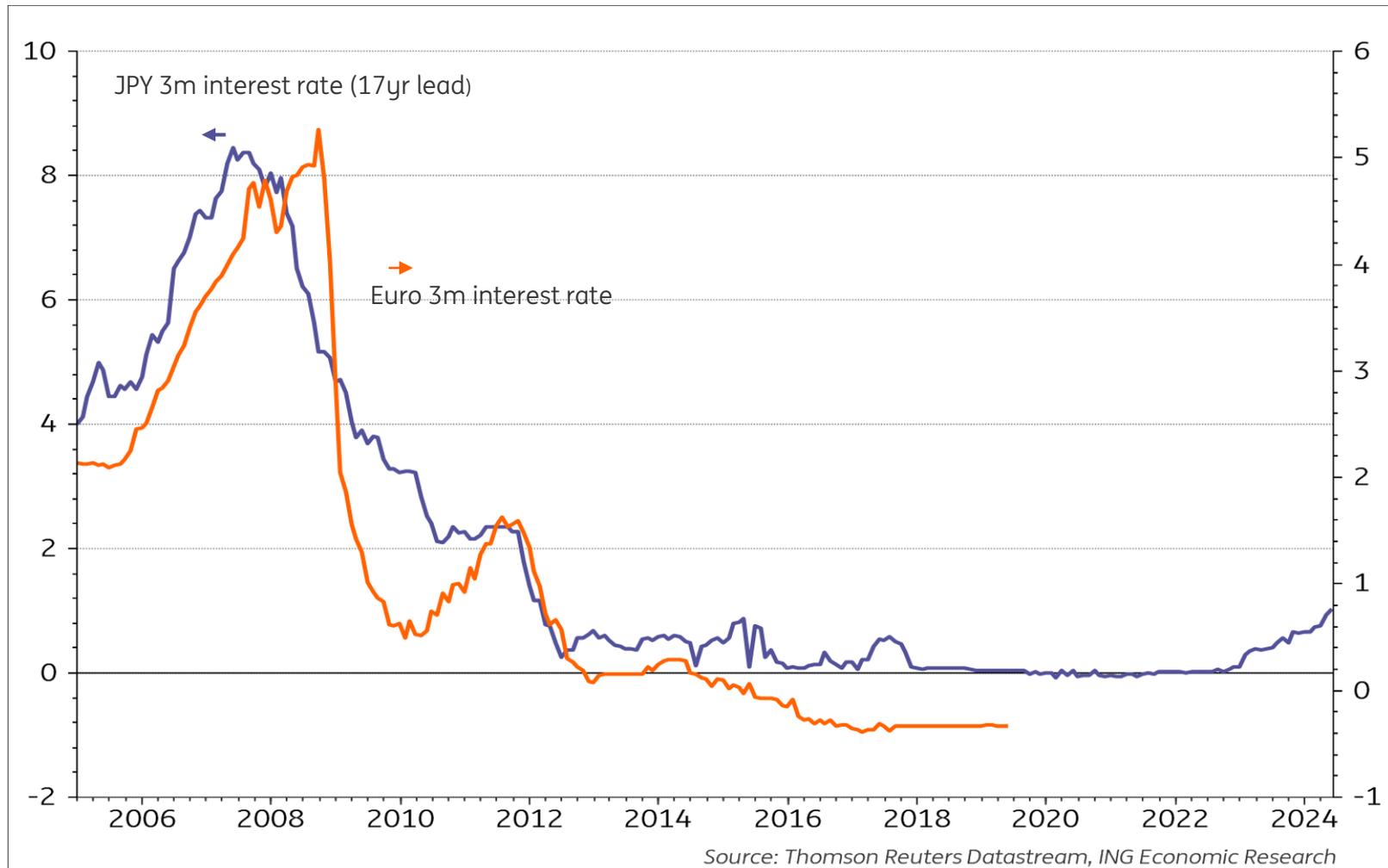
“Japanification gauge” based on the work of Takatoshi Ito (inflation, output gap, demographics,...)

Neutral level of short term rates has declined in the Eurozone

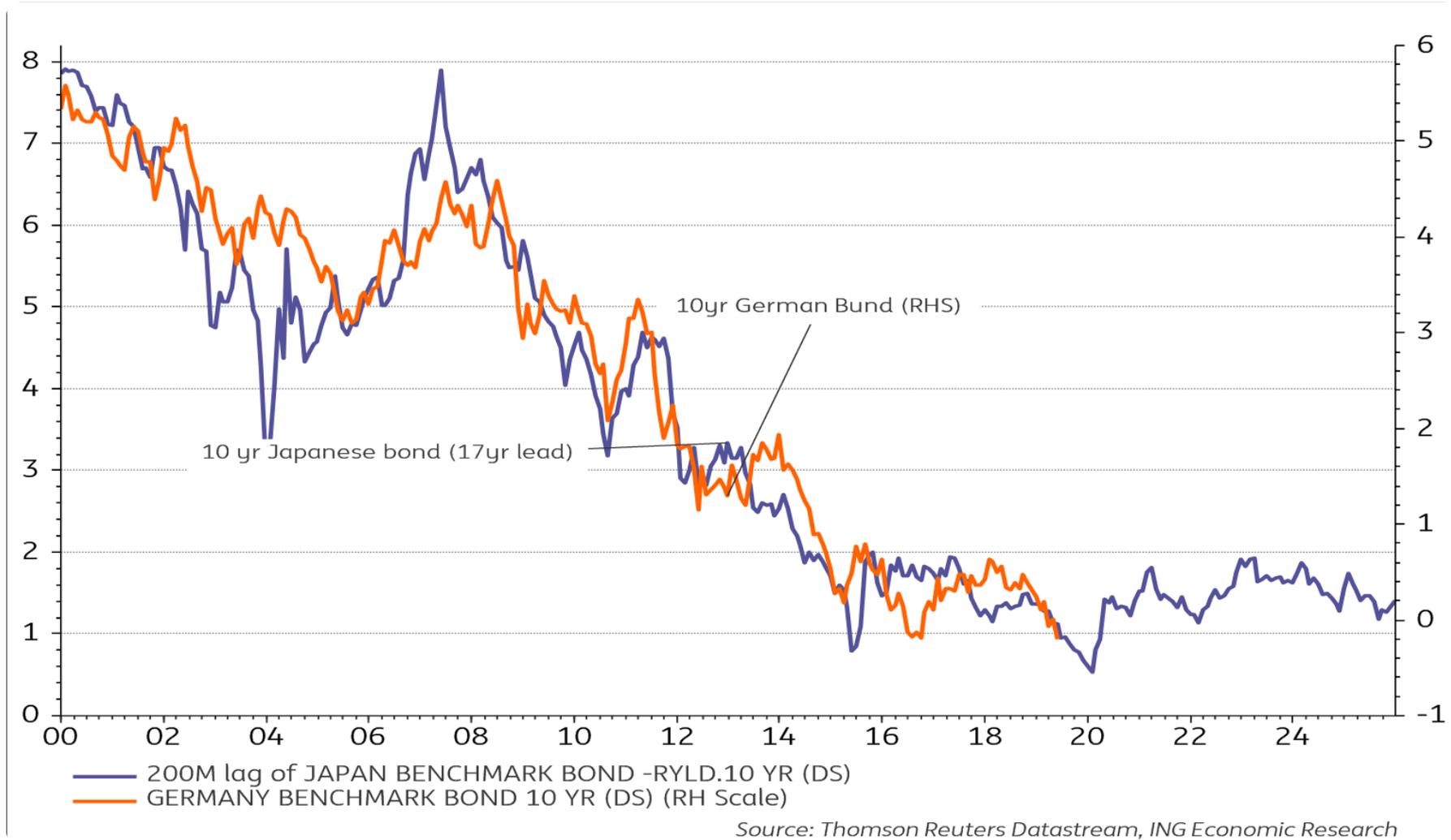


Source: ING based on Holston, Laubach, and Williams (2017)

Will 0% short term rates become the new normal?



Bond yields are bound to stay low



Conclusions

- World economic growth is threatened by escalating trade conflict
- US expansion likely to end in 2020, Federal Reserve will start to ease from September onwards
- More stimulus to be expected in China
- Eurozone slows with Brexit and Italy hurting confidence
- ECB likely to cut rates in second half of 2019
- The gradual Japanification of Europe means that interest rates are likely to remain very low for years to come

“The Big Blink”

When Wall Street Becomes too Big to Fail

Steven Vandepitte, Strategist

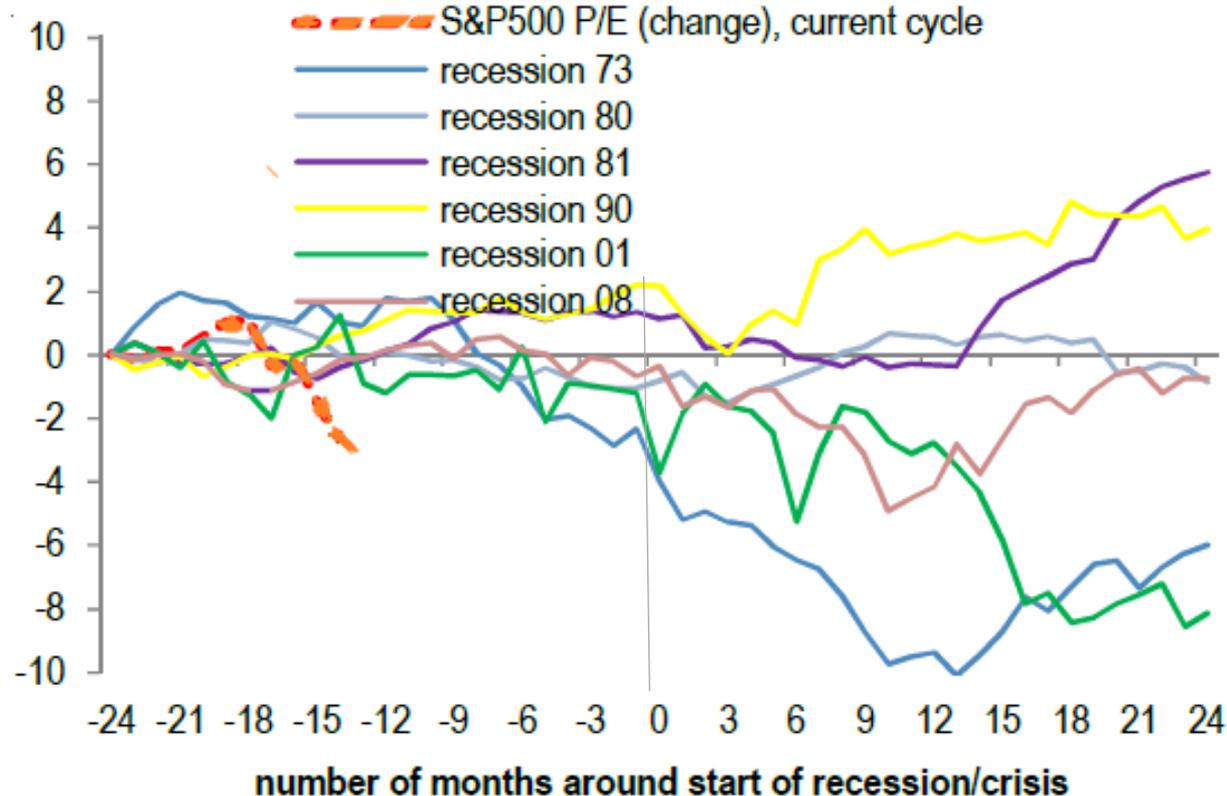


Brussels • June 13, 2019

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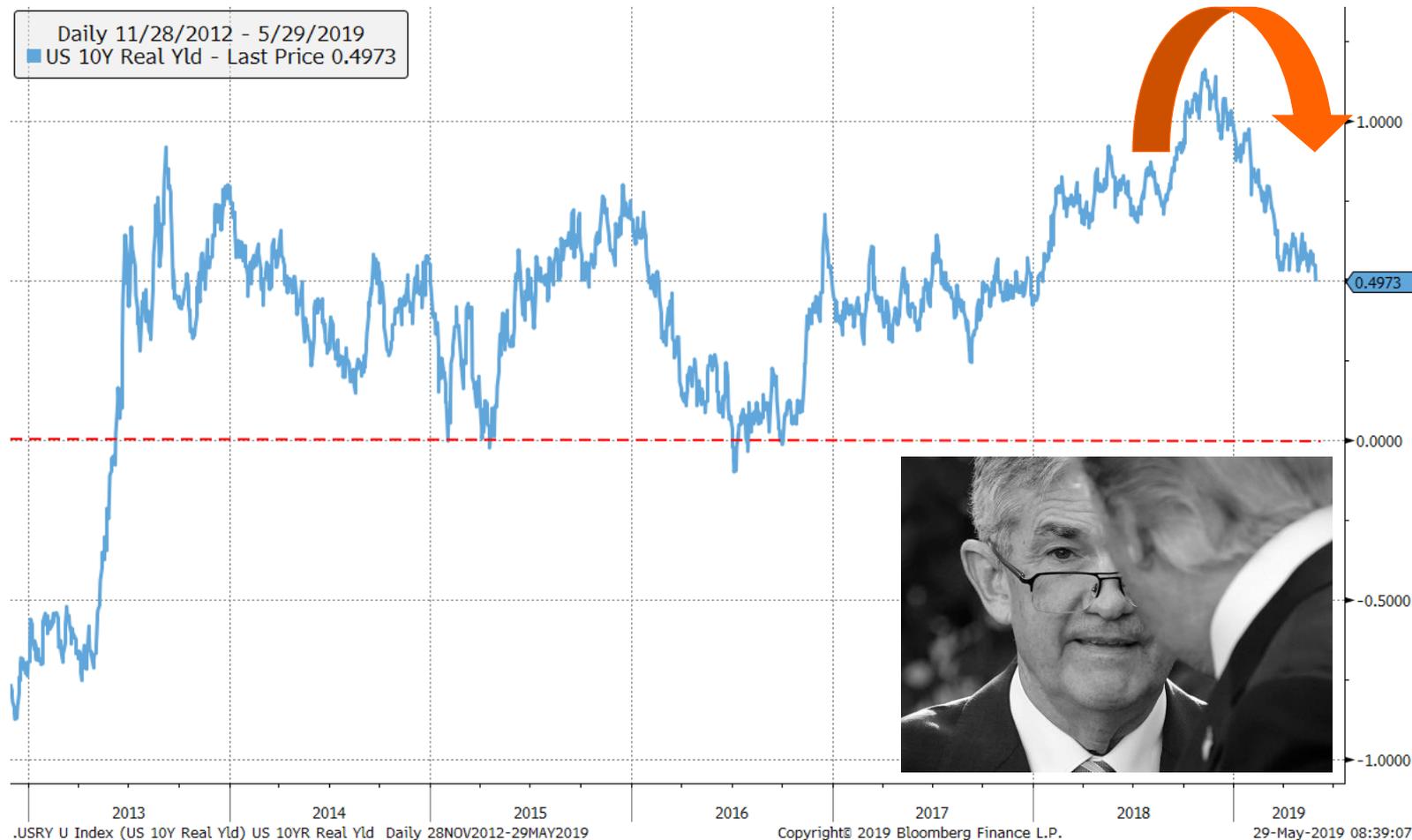
The Recession was priced on December 31, 2018

Cumulative change in S&P500 forward P/E ratio in two years before and after start of US recessions. Current cycle assumes recession begins in Q1 2020.



Source: JP Morgan, ING

The Fed blinked a first time and dished out its medicine

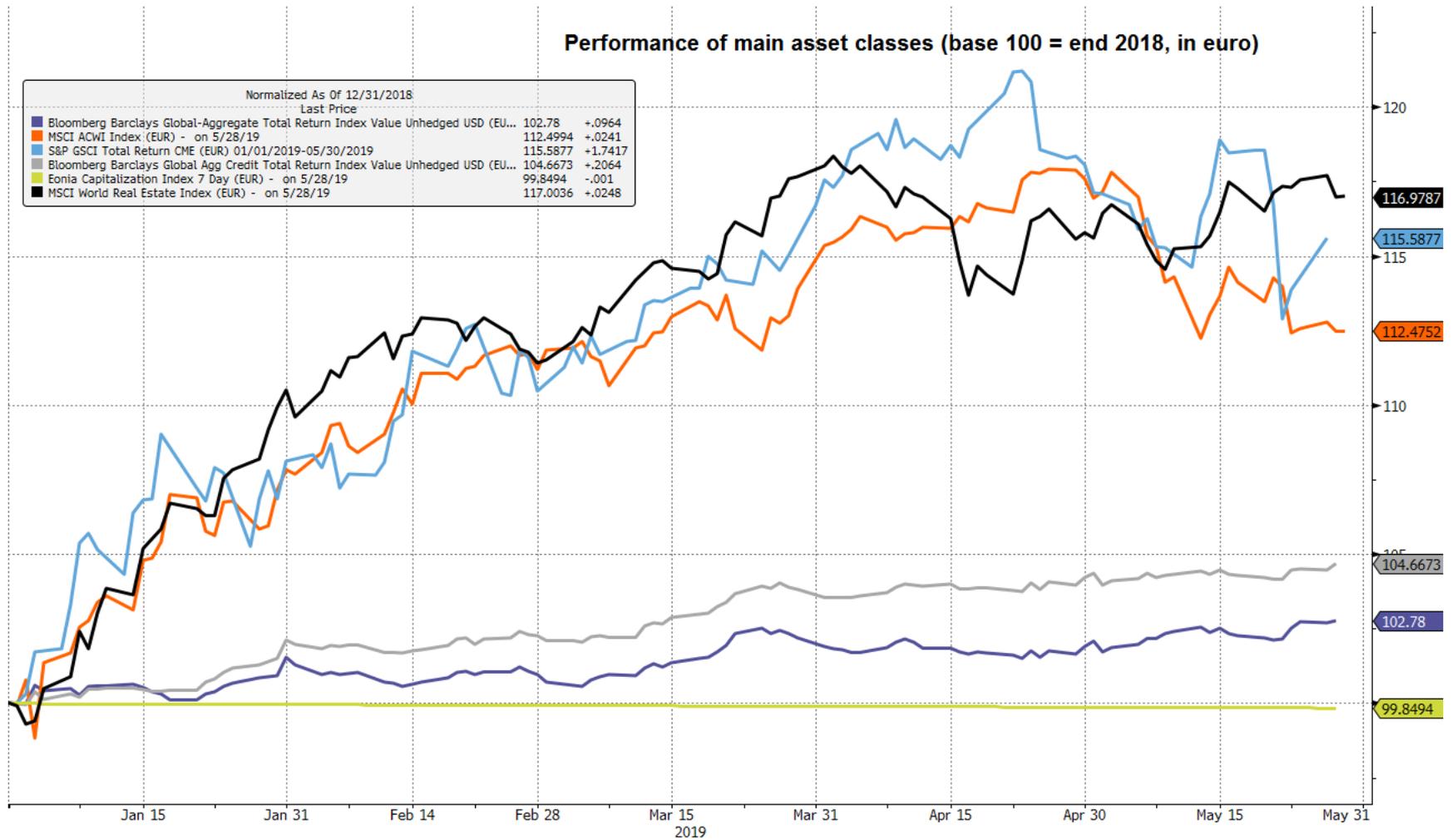


Has Wall Street become 'Too Big to Fail' ?

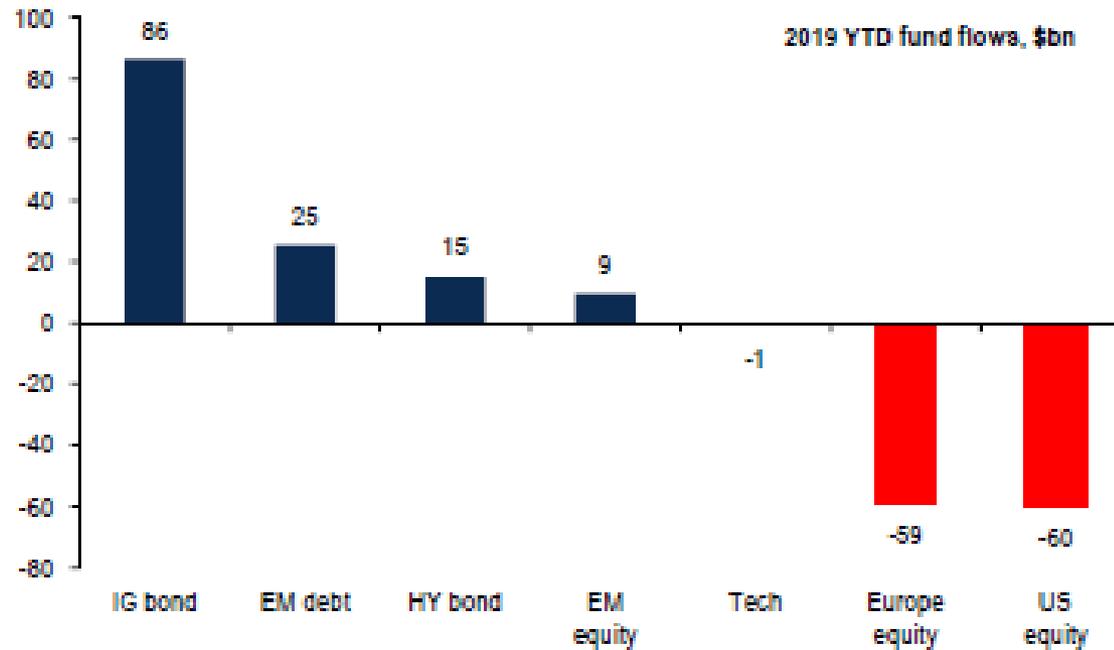
Recession	Key Contributors to NBER-dated US Recessions				
	Industrial	Oil	Monetary	Financial	Fiscal
Aug 1918					
Jan 1920					
May 1923					
Oct 1926					
Aug 1929					
May 1937					
Feb 1945					
Nov 1948					
Jul 1953					
Aug 1957					
Apr 1960					
Dec 1969					
Nov 1973					
Jan 1980					
Jul 1981					
Jul 1990					
Mar 2001					
Dec 2007					

Source : Goldman Sachs, ING

Then along came the rebound



The average investor isn't really buying into the equity story though



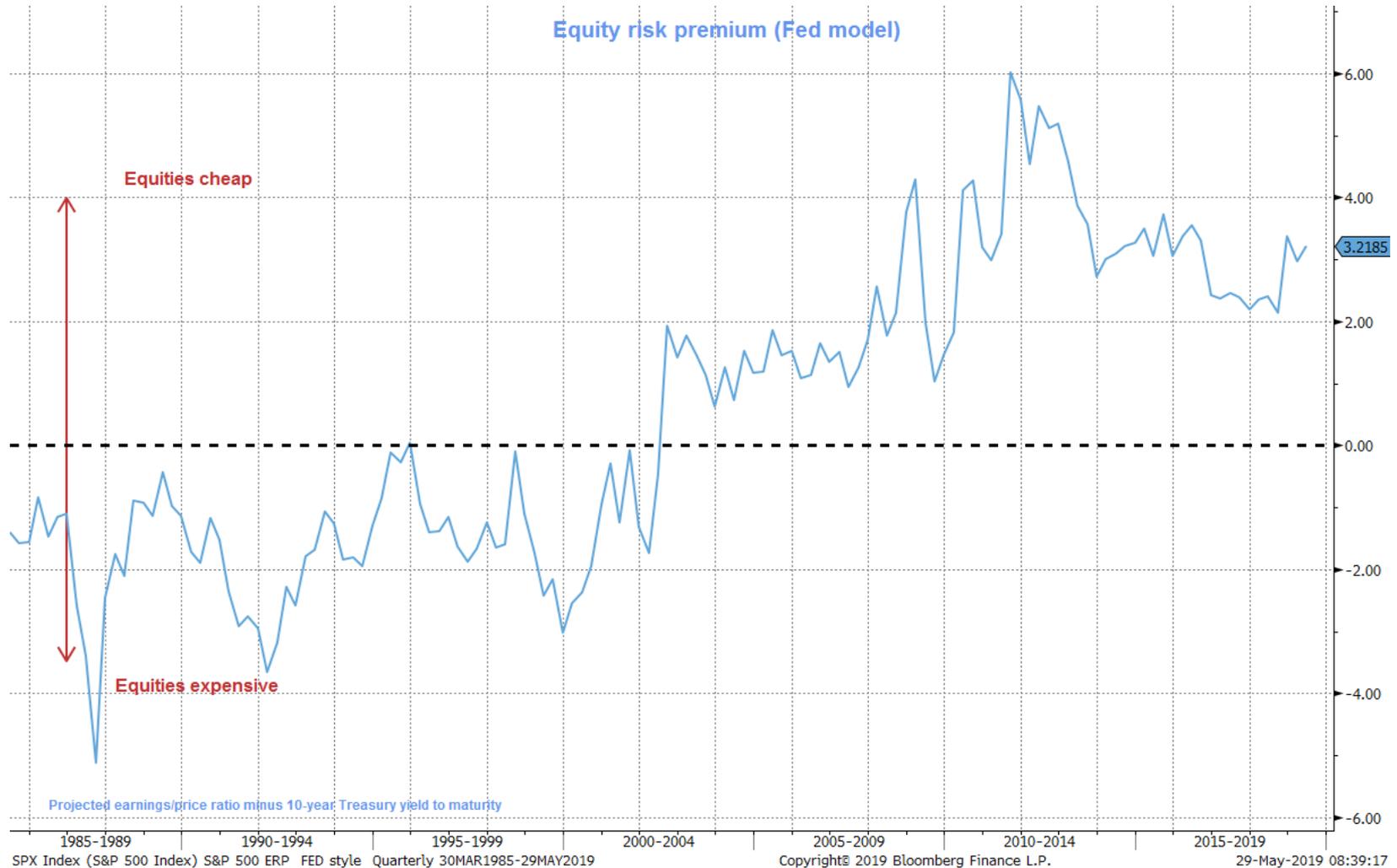
Source: BofAML Global Investment Strategy, EPFR Global

The buyer of last resort

On a shopping spree
Nr of shares bought back (in millions)



As long as the price is right



What's priced in equity markets: too much Goldilocks & not enough tail risk

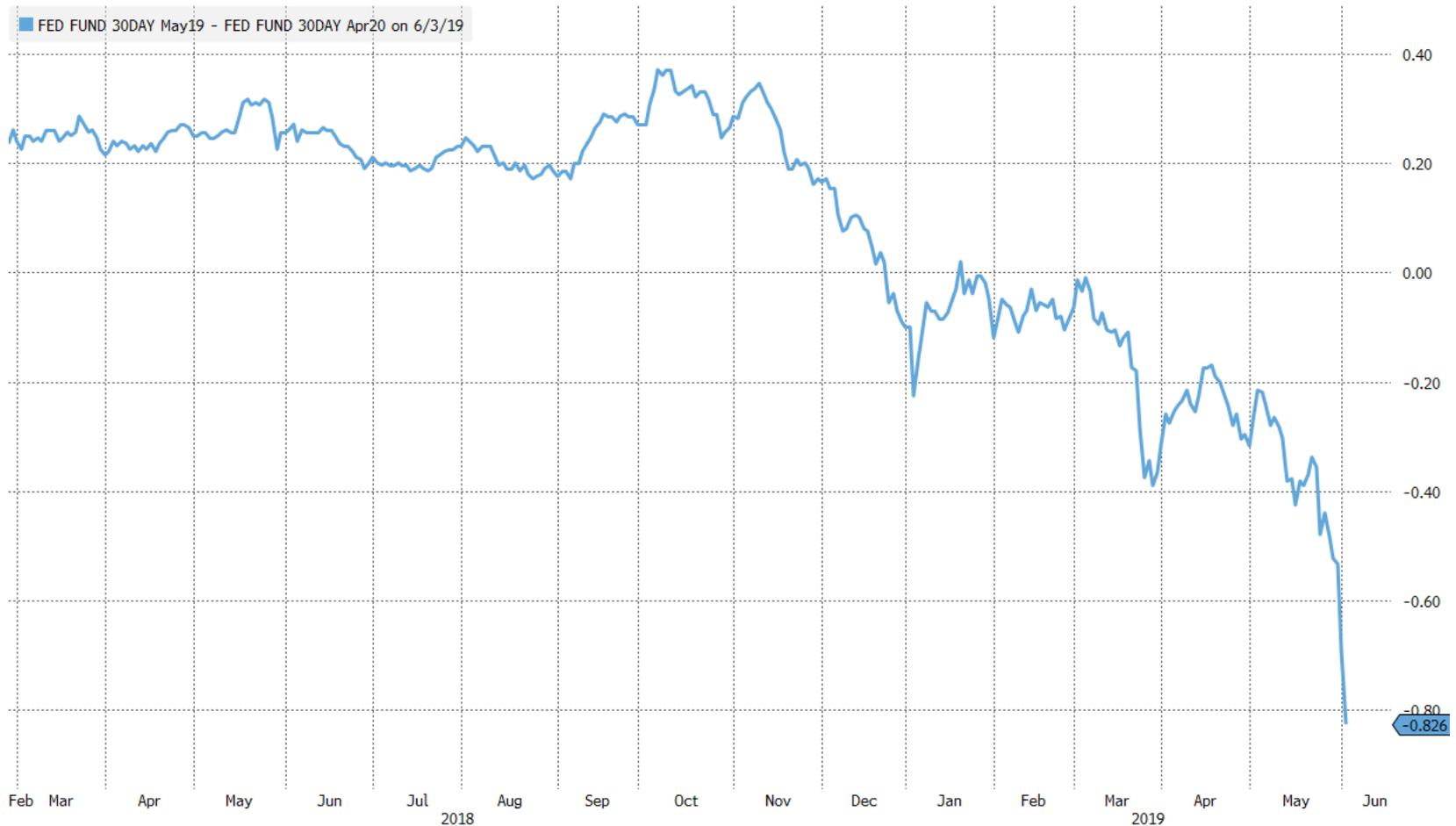


Catalysts to send risk markets materially higher in H2:

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Is a market riot going to force the Fed to blink a second time?

Where Did All Those Hikes Go?



Source: Bloomberg

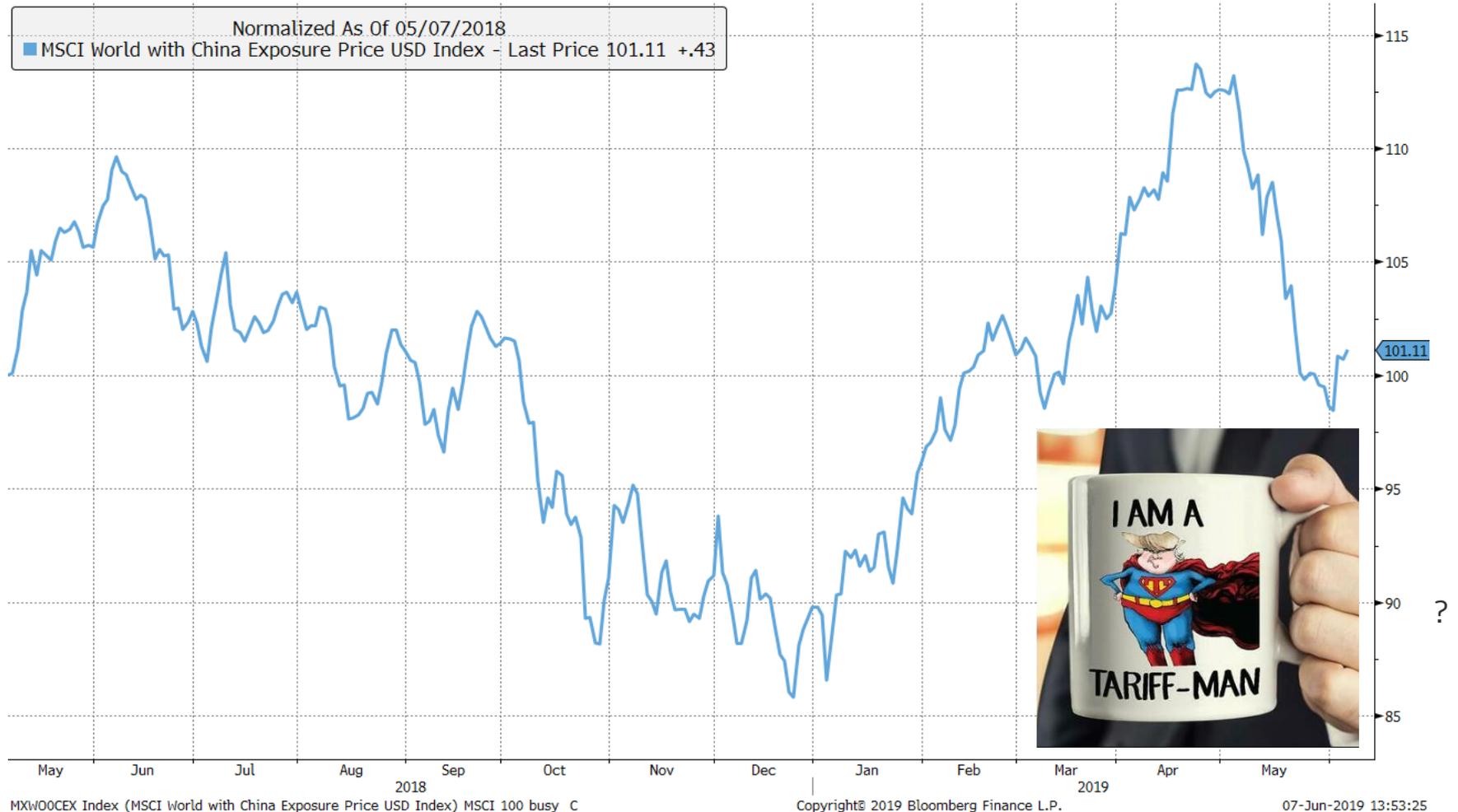
FFK9 Comdty (FED FUND 30DAY May19) Fed funds pricing Daily 26FEB2018-07JUN20

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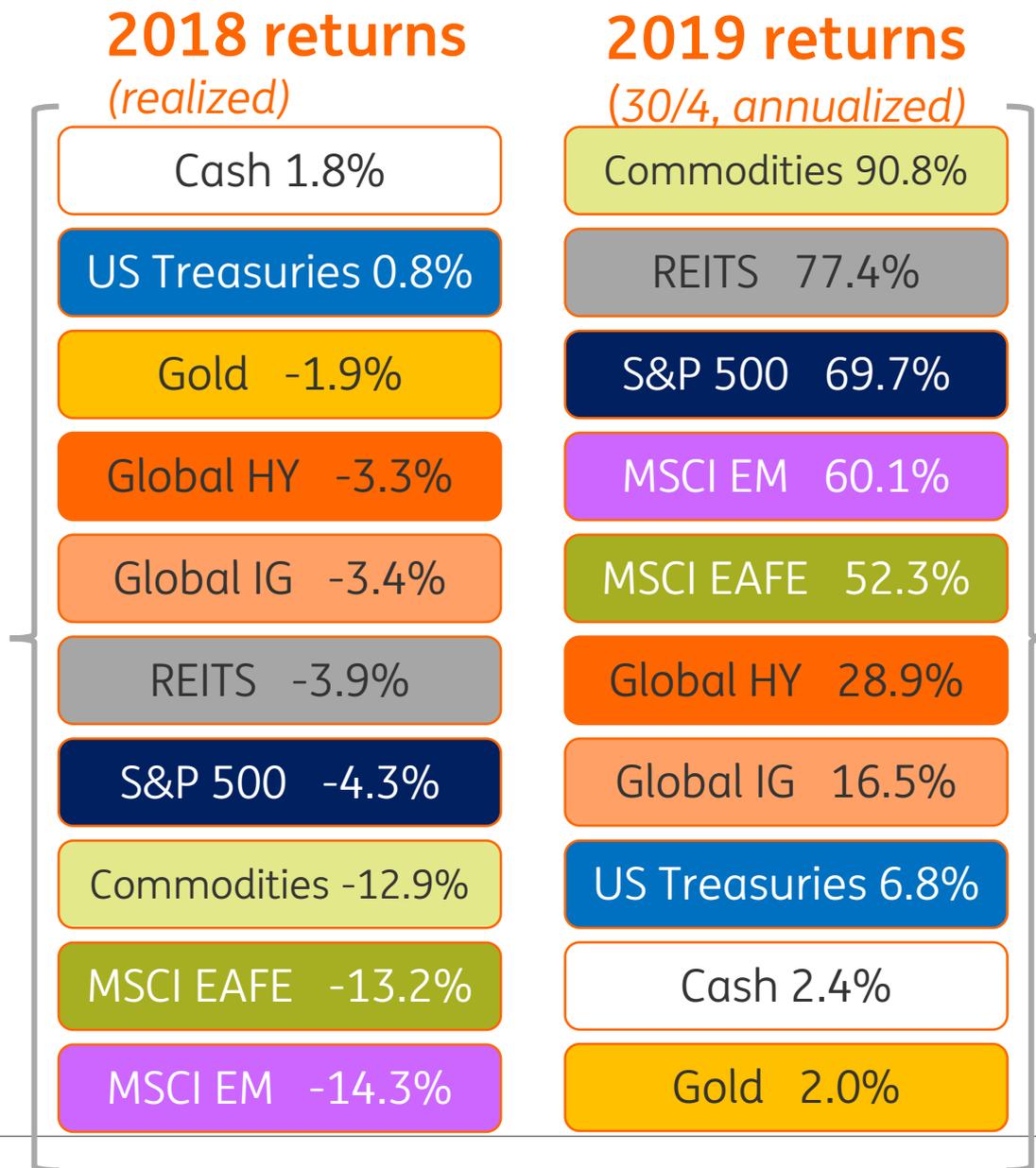
07-Jun-2019 13:52:35

It started with a tweet: after a very solid 4 months, finally the consolidation

Trade deal priced?



A consolidation looking for an excuse



We continue to have our doubts on earnings expectations



The earnings canary in the coalmine



Source: Thomson Reuters Datastream, ING Economic Research

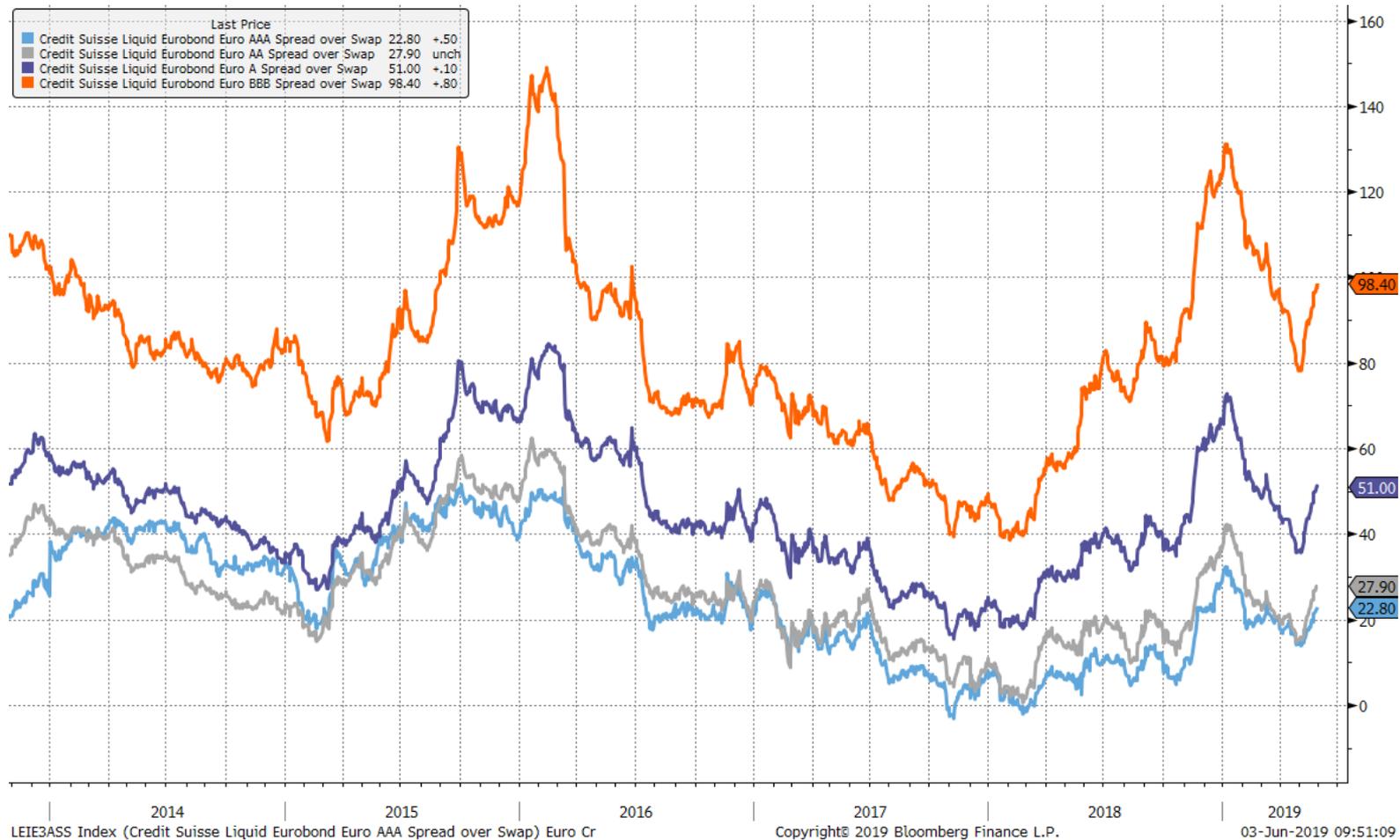
All quiet on the currency front



China can't sink the US Treasury market

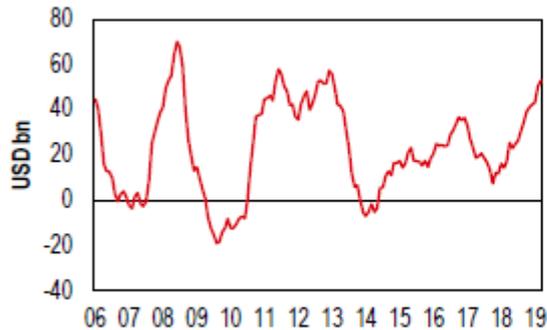


In € corporate bond land, it seems like QE never ended

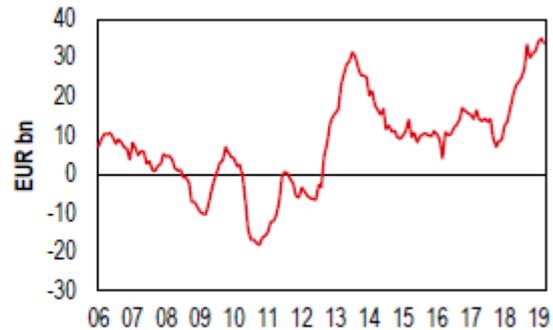


Japanification also means internationalization

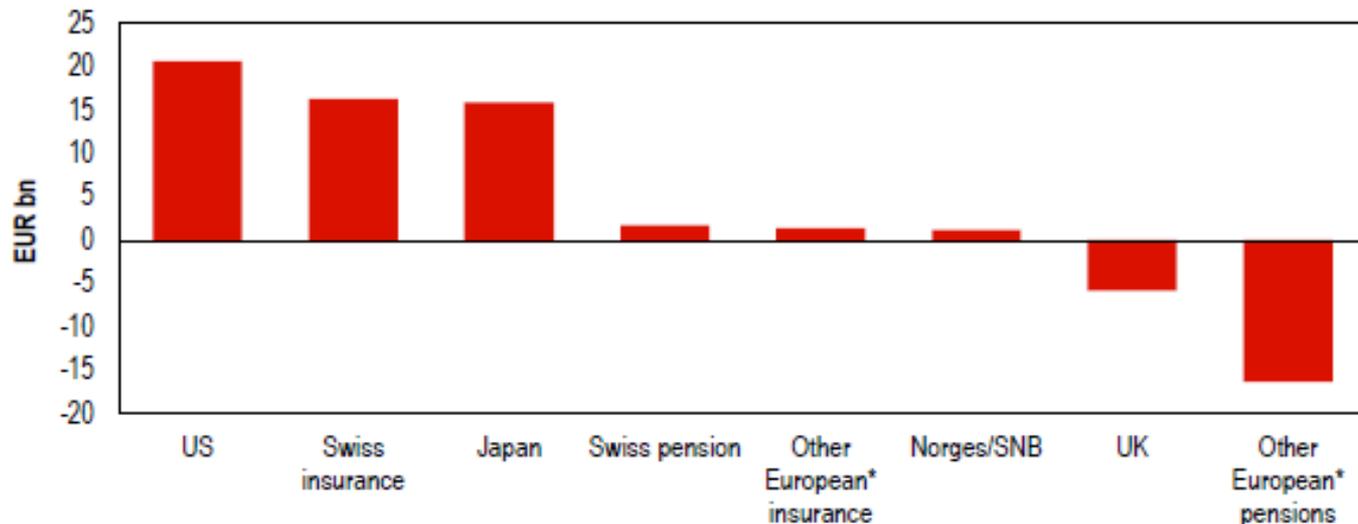
Japanese purchases of USD credit



Japanese purchases of EUR credit



Top foreign buyers of EUR credit, 2017-2018

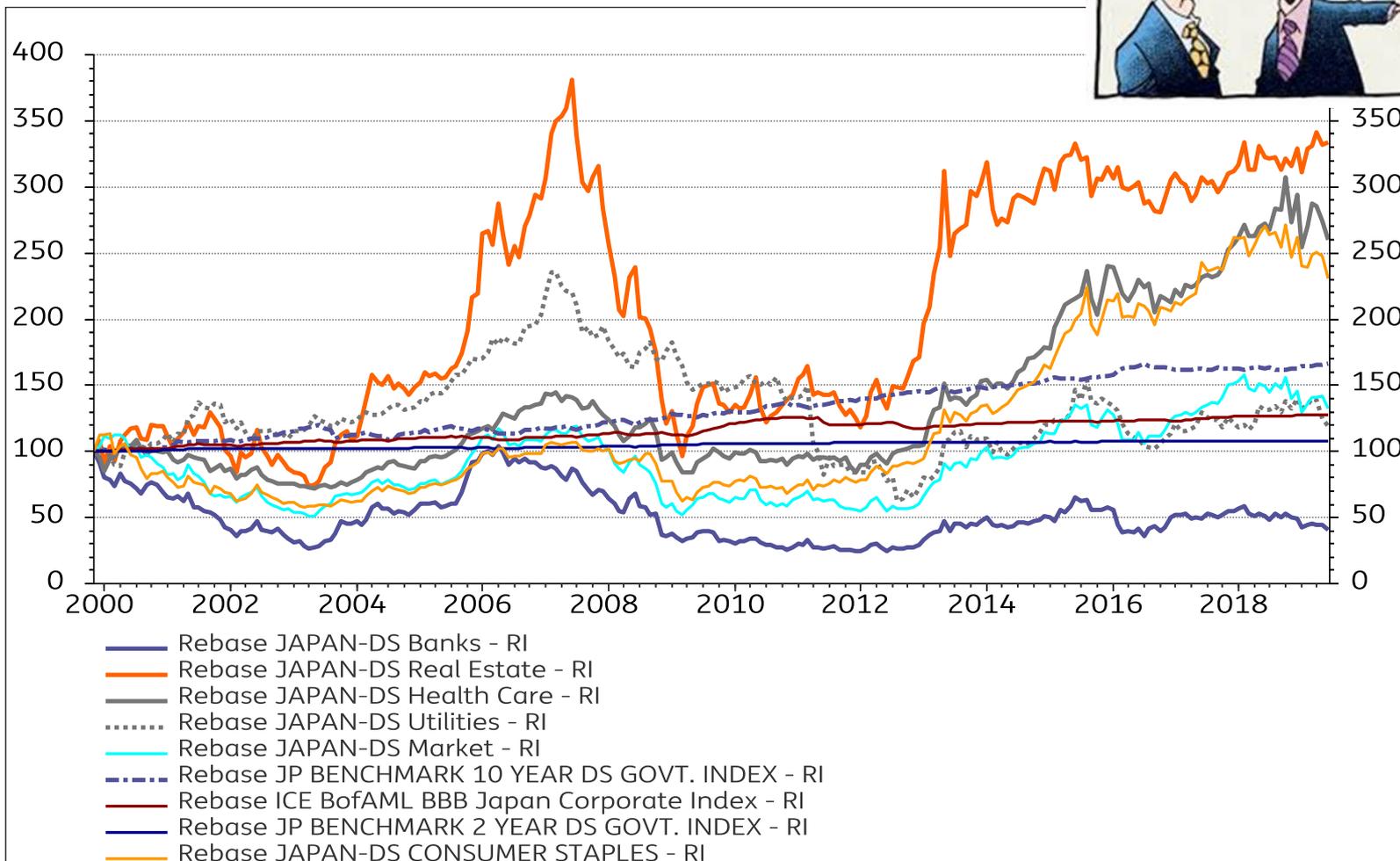


Source: HSBC calculations, OECD, Mercers, EIOPA, US TIC, UK ONS Pink Book, Japan Ministry of Finance, Swiss Financial Market Supervisory Authority (FINMA), BIS, ECB, Norges, SNB

*Includes European countries excluding Eurozone, UK and Switzerland

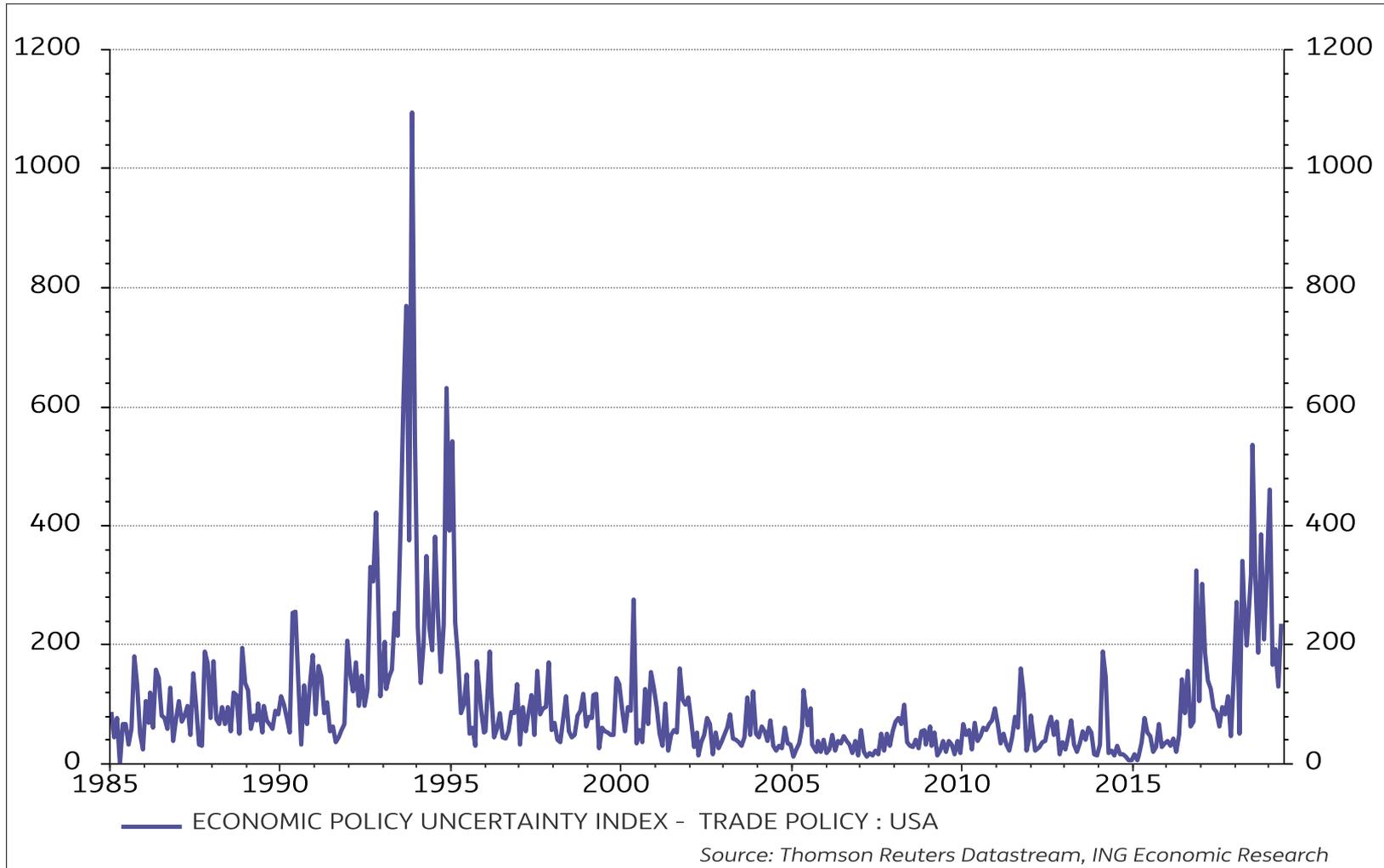
Japanification: 20 years of history

Total return indices for Japanese assets since BOJ hit zero %



Source: Thomson Reuters Datastream, ING Economic Research

Tariff may be 'a beautiful word', but not in a Wall Street dictionary



Use rallies to manage portfolio risk lower

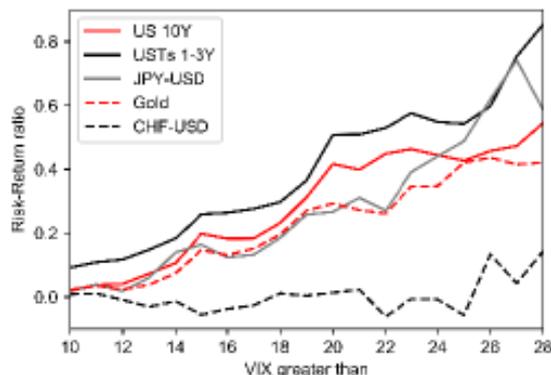
- **Late cycle backdrop means portfolio moves ‘up in quality & up in liquidity’**
 - GRADUAL move to more defensive sectors/equities
 - Preference for developed market equity over EM
 - Large cap rather than small cap
 - Cautious on ‘Credit’ at current low spreads and earnings potentially under pressure
 - ‘Safe’ government bonds / duration for stabilizing the portfolio
- **The Federal Reserve, keenly aware of where we are in the cycle, will do anything not to provoke a recession**

Just in case : *before* things really deteriorate



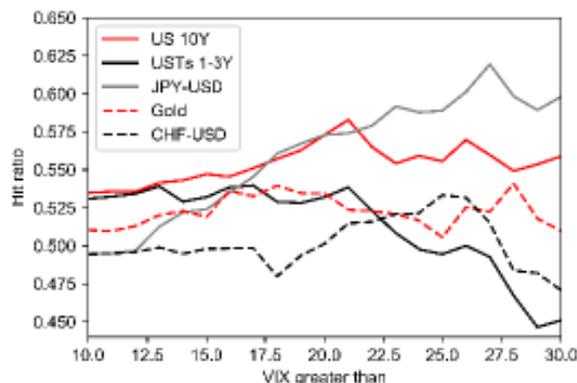
...Time to buy some safe havens

3. Risk return ratio conditional to VIX level over 2010-16...



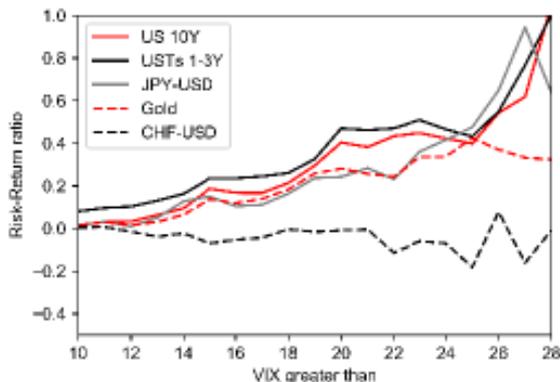
Source: HSBC, Refinitiv Datastream
Note: data filtered for various levels of VIX 2010-2016; US Treasuries are calculated on a total return basis.

4. Hit ratio conditional on VIX levels over 2010-16³



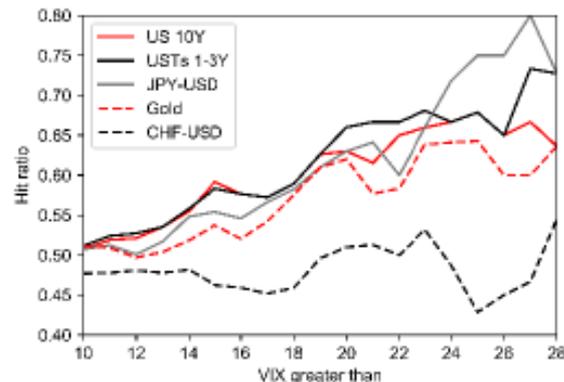
Source: HSBC, Refinitiv Datastream
Note: data filtered for various levels of VIX 2010-2016; US Treasuries are calculated on a total return basis.

5. Risk-return ratios since 2016



Source: HSBC, Refinitiv Datastream
Note: data filtered for various levels of VIX since 2016; US Treasuries are calculated on a total return basis.

6. Hit ratios since 2016



Source: HSBC, Refinitiv Datastream
Note: data filtered for various levels of VIX since 2016; US Treasuries are calculated on a total return basis.

TAA Summary

Date : 11/06/2019		UW	N	OW	Δ			UW	N	OW	Δ
Asset Allocation	Bonds	X				Size	Large Cap US			X	
	Cash			X			Small Cap US	X			
	Equities	X					Large Cap Europe			X	
Equity Sectors Europe	Utilities		X			Style	Small Cap Europe	X			
	Communication Services		X				Growth	X			
	Consumer Staples			X		Bonds Fixed Income	Value			X	
	Healthcare			X			EMU govies	X			
	Consumer Discretionary		X			Credit	Global IL			X	
	Industrials	X					EMD LC			X	
	Materials	X					Core -Periphery EMU			X	
	Technology		X			COMMODITIES	IG	X			
	Energy		X				GHY	X			
Financials		X			EMD HC				X		
Equity Sectors US	Utilities		X			REITS			X		
	Communication Services			X			FX v. EUR				
	Consumer Staples			X				USD		X	
	Healthcare		X			GBP			X		
	Consumer Discretionary		X			CHF		X			
	Industrials	X				JPY			X		
	Materials	X									
	Technology		X								
	Energy		X								
Financials			X								
Regions	US			X							
	Eurozone			X	↑						
	Japan			X	↑						
	EM	X									

Questions?



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