ARTICLE
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For professional investors

Change in Asset Allocation

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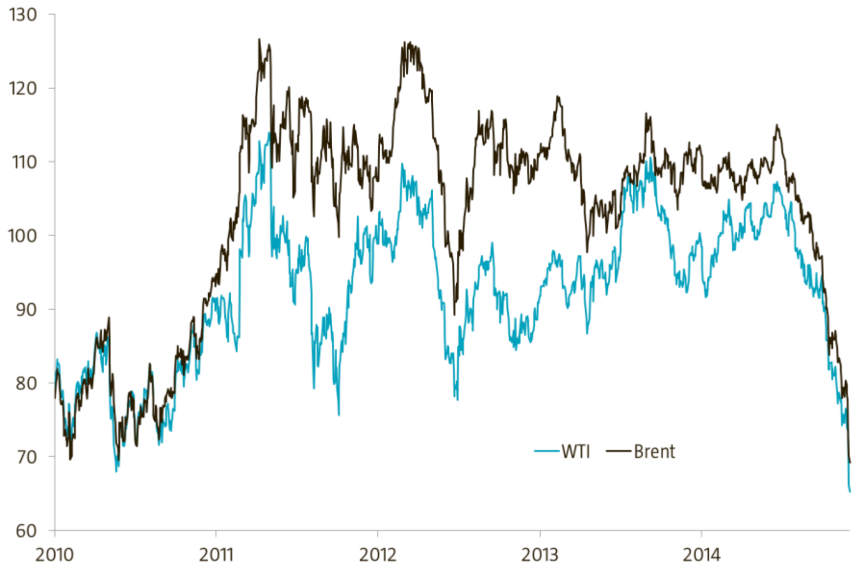
"Switching from High Yield to Equities"

What started out as a gradual decline in the oil price has in recent weeks developed into a real selling frenzy. Since mid-June, oil prices have dropped by 40%. Last week's decision by OPEC not to cut production levels was the final straw that pushed oil below the USD 70 mark, the lowest level since 2009. There were two main reasons behind this correction – declining demand due to the weak growth prospects of the world economy and rising supply linked to the shale gas revolution in the US.

Oil price plummets

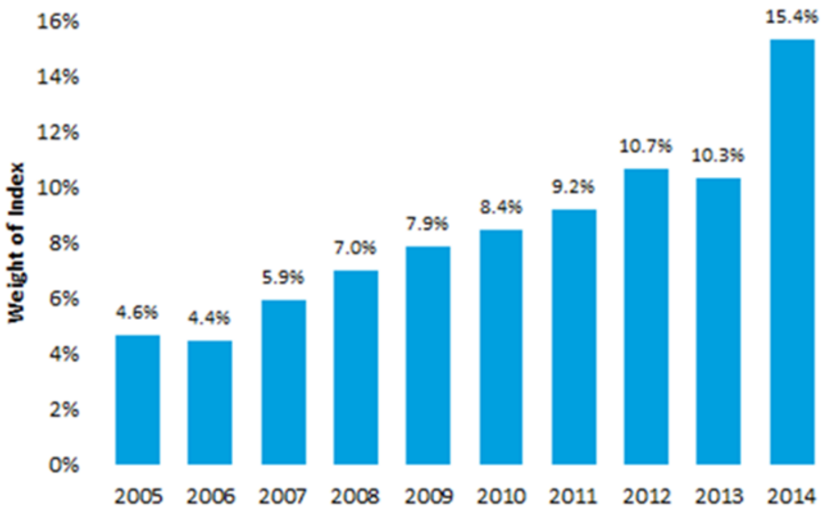


Source: Bloomberg/Robeco

Although on balance we think this will be a positive growth stimulant for the world economy, it is clear that there are potential negatives as well. Specifically we see the risks involved for the oil producing companies and as a result the High Yield market:

- A rising share of the US High Yield market is linked to the oil producing sector, which is a reflection of the rapidly growing shale industry. From less than 5% in 2006, the share of oil related companies has risen to above 15% in 2014 (see chart below), with some sources putting the current level at 17.5%. It is clear that the drop in the oil price has increased the risk of defaults in this sector. Trackers and ETFs in High Yield will feel the impact in the case of such an event.

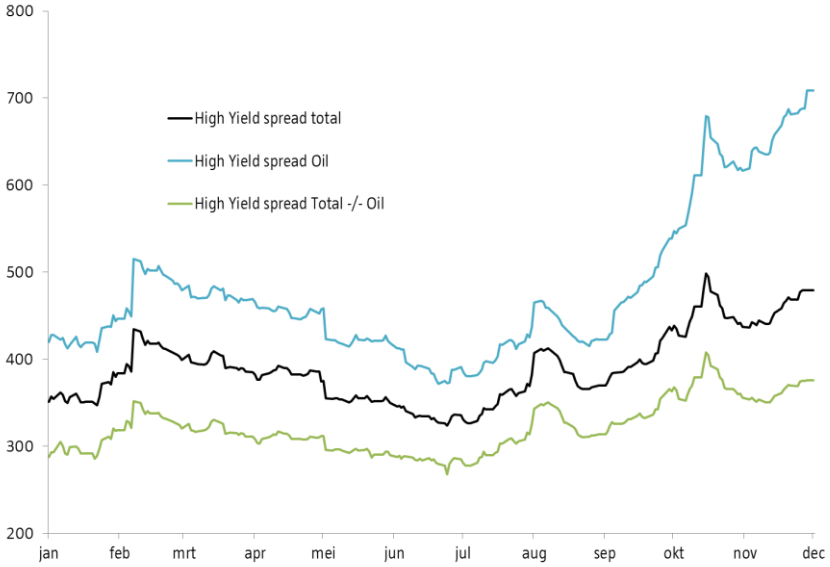
Rising share of oil producers in the US High Yield market



Source: Schwab

- In the event of a default by one of the shale producers, we think the risk of a direct economic spillover to other sectors is limited. However, we would expect the knee-jerk reaction to be more one of spread widening, as it will raise the overall risk awareness in the market. In fact, the spread widening we have seen so far in the overall High Yield market can already to a certain extent be attributed to the developments in the oil sector. Although we would view this trend in the overall market as a longer term buying opportunity, from a multi-asset allocation point of view, we see better value in equities.

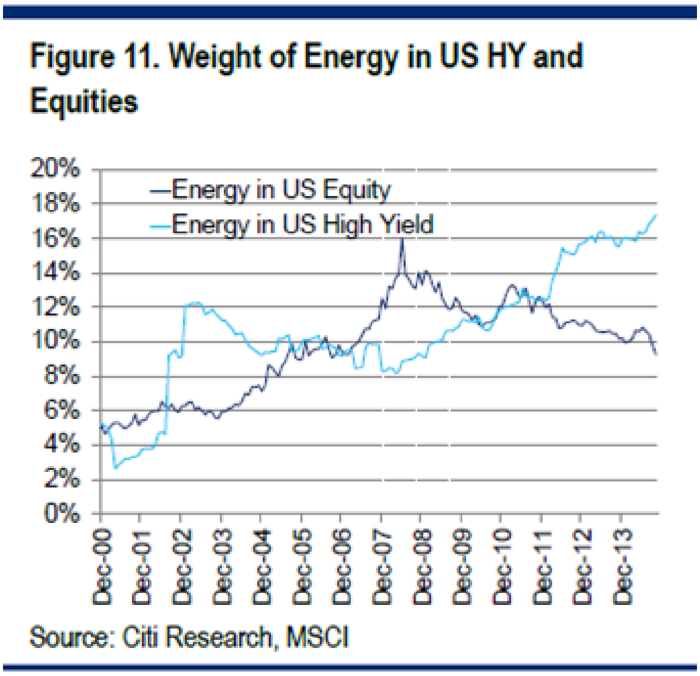
Spread widening in the High Yield market



Source: Bloomberg/Robeco

- Whereas exposure to the US energy sector in the High Yield market has increased steadily, the opposite is true for US equities. As such, the impact from a possible default will be less severe for stocks.

Spread widening in the High Yield market



- We expect the overall impact of the oil price decline to be a net positive for the economic outlook. It will boost final (consumer) demand as real disposable income for non-energy consumption is set to increase. Additionally, margins for the cyclical and energy dependent companies are set to strengthen. So whereas the risk-reward profile for High Yield has deteriorated, the opposite is true for equities.

Change in multi-asset portfolio
All in all, we have decided to lower our exposure to High Yield by 3%, in favor of Developed Market Equities. Following this reshuffle we are still overweight High Yield, as we expect the search for yield to remain an important theme for the next few months. As such, we still see any sell-off in High Yield as a buying opportunity. Having said that, we currently see a better risk-reward trade-off elsewhere.

Multi asset portfolio versus benchmark

	Portfolio	BM	active	previous
Equities Developed Markets	32.0%	25.0%	7.0%	4.0%
Equities Emerging Markets	5.0%	5.0%		
Real Estate Equities	2.5%	5.0%	-2.5%	-2.5%
Commodities	5.0%	5.0%		
Core Gov Bonds 1-10	15.0%	20.0%	-5.0%	-5.0%
Core Gov Bonds 10+	7.5%	7.5%		
Investment Grade Corp Bonds	19.0%	20.0%	-1.0%	-1.0%
High Yield Corp Bonds	7.0%	5.0%	2.0%	5.0%
Emerging Market Bonds LC	5.0%	5.0%		
Cash	2.0%	2.5%	-0.5%	-0.5%
EUR/USD	-2.0%	0.0%	-2.0%	-2.0%
EUR/JPY	1.0%	0.0%	1.0%	1.0%
EUR/GBP	0.0%	0.0%		
EUR CASH	1.0%	0.0%	1.0%	1.0%
Portfolio risk	5.05%	4.55%		