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Moving back to overweight in equities

Door Lukas Daalder, CIO Investment Solutions

The equity market sell-off has been overdone and it is now time to get back into stocks, says Lukas Daalder, Chief Investment Officer for Robeco Investment Solutions.

Fears over Chinese growth, the devaluation of its currency and a crash in its overheated stock market led to a major 'correction' on global markets, with stocks falling across the world. China reacted by cutting its interest rate on 25 August and encouraging public investment schemes such as pension funds to buy into the market.

Robeco Investment Solutions, which runs the multi-asset funds, is now moving back to an overweight position in global equities from the neutral stance adopted earlier this summer, believing that stocks now offer a much better risk/reward trade-off.

"We think the market reaction in the developed equity markets is overdone. Although we expect Chinese growth to drift lower, we do not expect it to develop into a hard landing," says Daalder. "The devaluation of the yuan does mean that China is shifting part of the growth-slowdown burden to the rest of the world, but the 3% devaluation is neither shocking, nor excessive. To put things into perspective: the euro appreciated by 5% during the sell-off in the equity markets."

"Exporters of luxury goods will feel the pinch for sure, but this is already clearly reflected in the price development of stocks like Volkswagen (-30%) or LVMH (-20%). More in general, it seems unlikely that the central authorities in China will stand by and let growth dwindle: the interest rate cut administered yesterday is a clear indication of their intentions."

Concerns over Chinese growth
Daalder says China may be the new owner of the old adage that 'when America sneezes, the rest of the world catches a cold' following concern over its economic restructuring. "Although there are various issues with respect to China (the stock market crash, yuan devaluation and rebalancing of the economy), the common theme is that they all raise doubts about the sustainability of the underlying growth of the Chinese economy," he says.

"These doubts have been further boosted by the ongoing decline of prices in most of the commodity markets, most notably oil and copper. Even though there are clear supply side issues at play here (shale in the US for example), it does raise concerns about underlying demand as well."

"And whereas the sell-off in the Chinese stock market initially was a local event, the decision to devalue the yuan in the middle of August acted as the wake-up call for the rest of the world. Since the surprise devaluation in August, the MSCI World index has dropped by 10% and European stocks are currently trading 16% below the high reached in April. But those falls are a reaction to China, when investors should also be looking at Western growth levels," he says.

Rates and consumption support Europe
"Looking beyond China, both in the US and Europe, growth has been steady and we see no reason to expect a marked change," he says. "The European economy is supported by low

interest rates, healthy consumption and the end of the austerity programs, while labor and housing markets are driving growth in the US. Added to this is the improvement in disposable income linked to the steady and ongoing decline in the price of oil, which will ultimately support consumption."

Daalder says it means the time has come to upgrade from a neutral stance, which had been caused by high valuations, an increase in volatility in bonds and currencies, and the Greek debt crisis of the time.

"Following the sell-off we are now moving back to an overweight position, in a step-by-step approach. Volatility is probably going to remain high for some time to come, but the risk-reward for equities has now become interesting again," he says.

Lukas Daalder
Lukas Daalder is Chief Investment Officer for Robeco's Investment Solutions and supervises the team of multi-asset portfolio managers and strategists. Lukas joined Robeco in 2009 as an investment strategist. Prior to that, he worked for three years as a delta-one trader at IMC Market Makers.