Petercam

Institutional
Asset Management

Petercam Outlook 2014

27. November 2013

- Economic outlook 2014
  - Bart Van Craeynest – Chief Economist
- Global asset class outlook 2014
  - Maarten Geerdink – Chairman Asset Allocation Committee

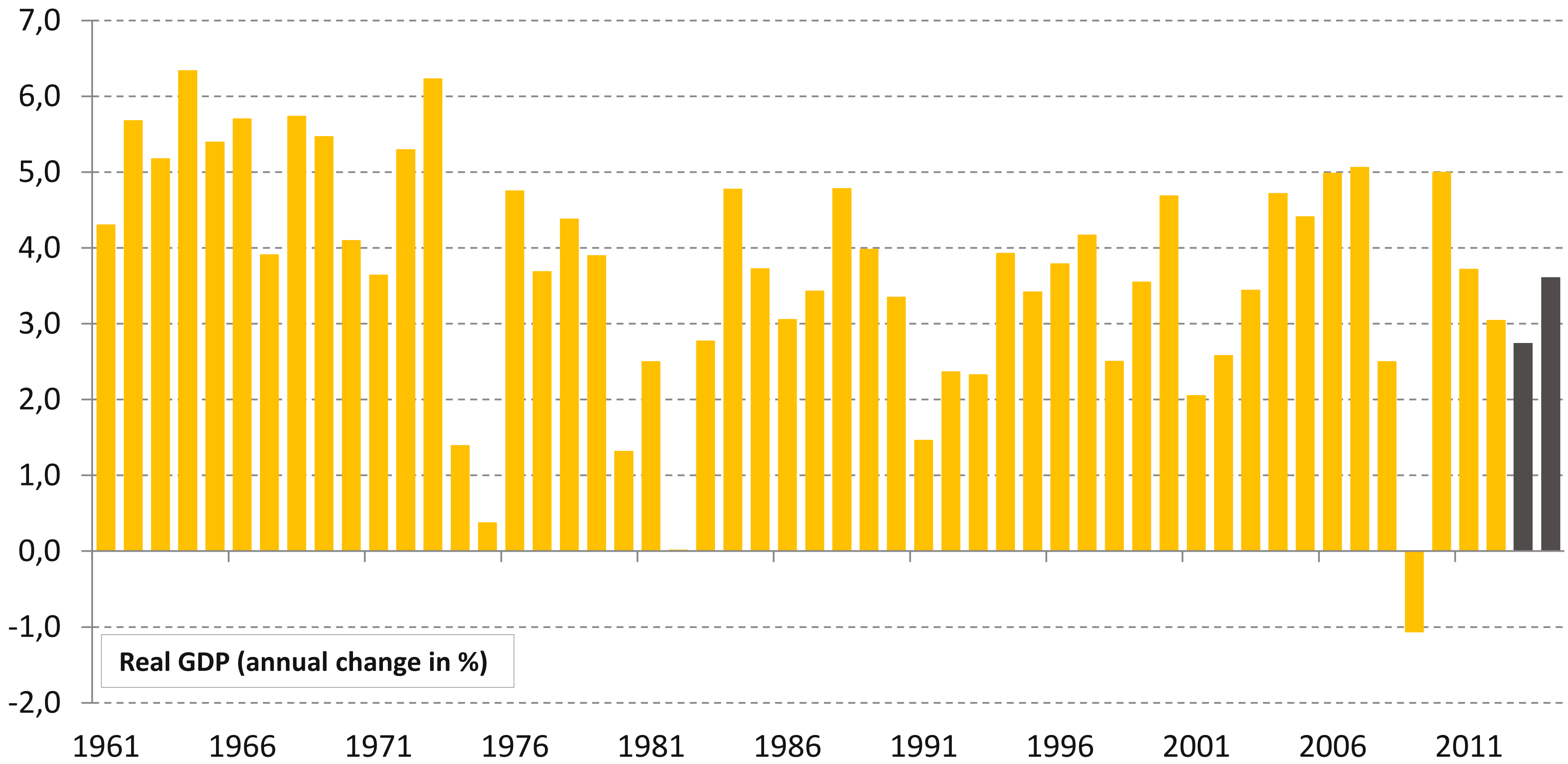
2013 outlook

- **Activity: picking up, fueled by US and EM**
- **Inflation: still under control**
- **Monetary policy: remains extremely supportive**
- **Fiscal policy: continued tightening in DM**

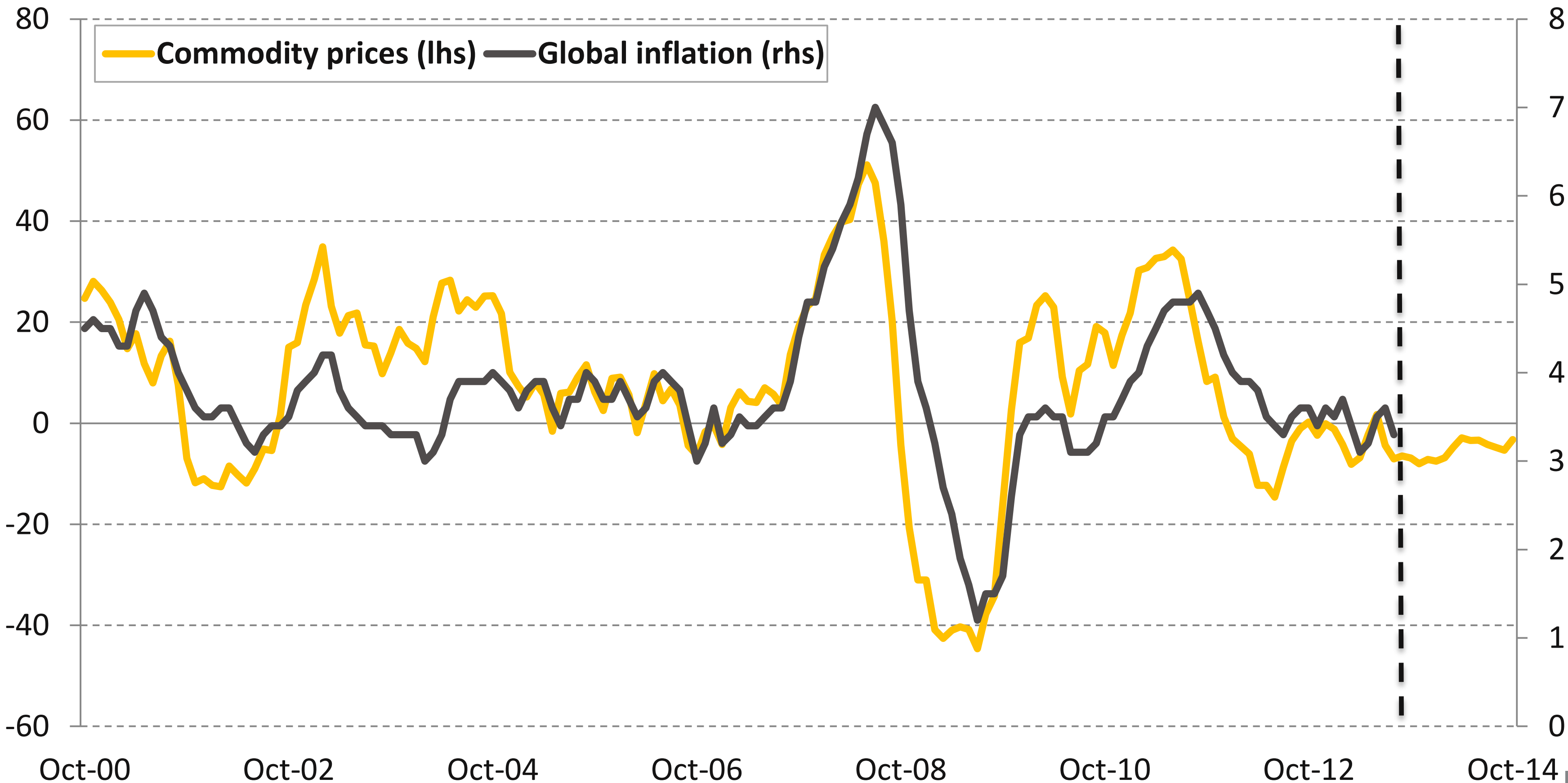
2014: more of the same

- Activity: global recovery, led by US
- Inflation: still under control
- Fed is key for financial markets
- Politics remain important

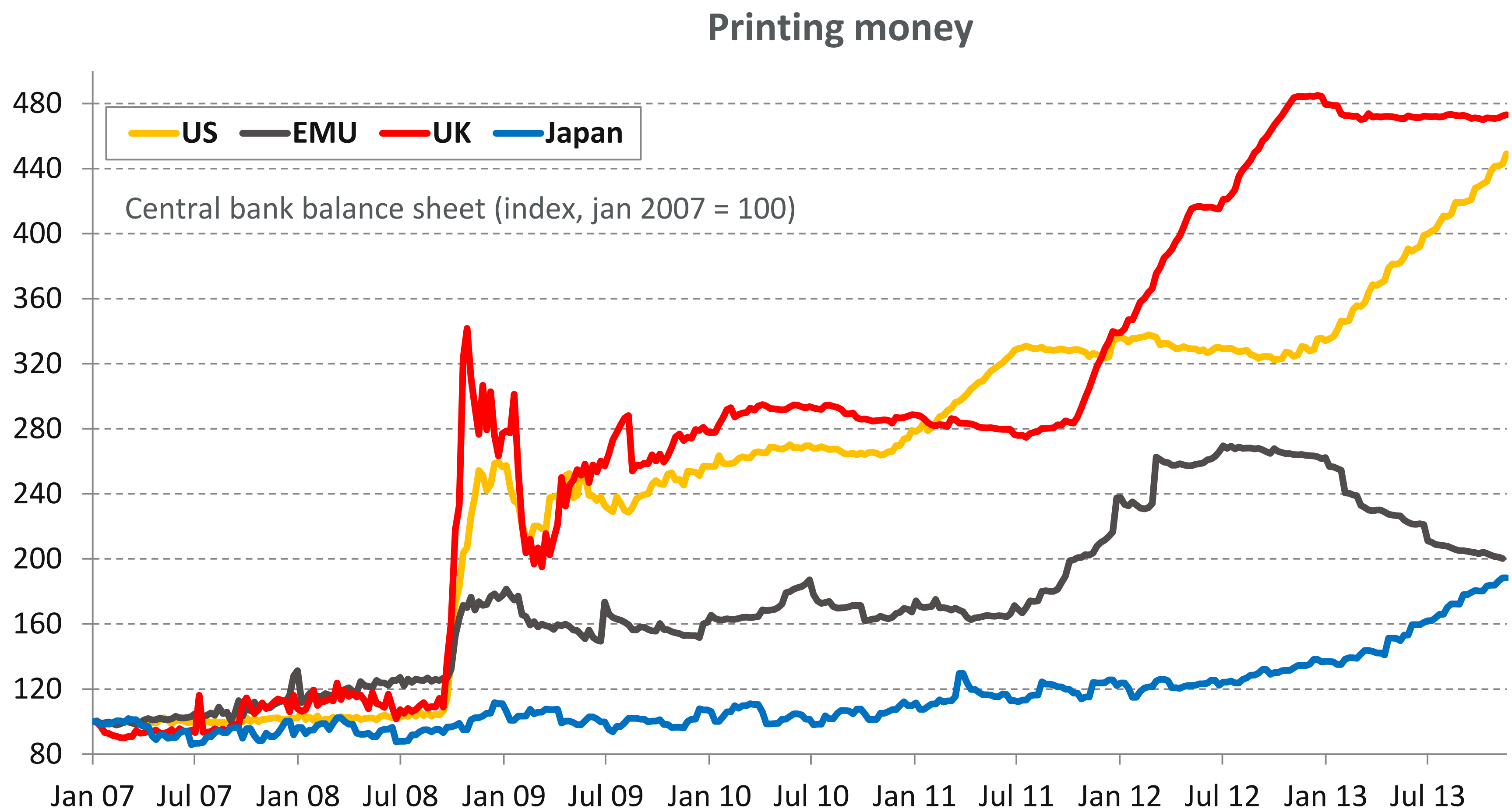
Global recovery



Inflation remains under control



Monetary policy remains very supportive



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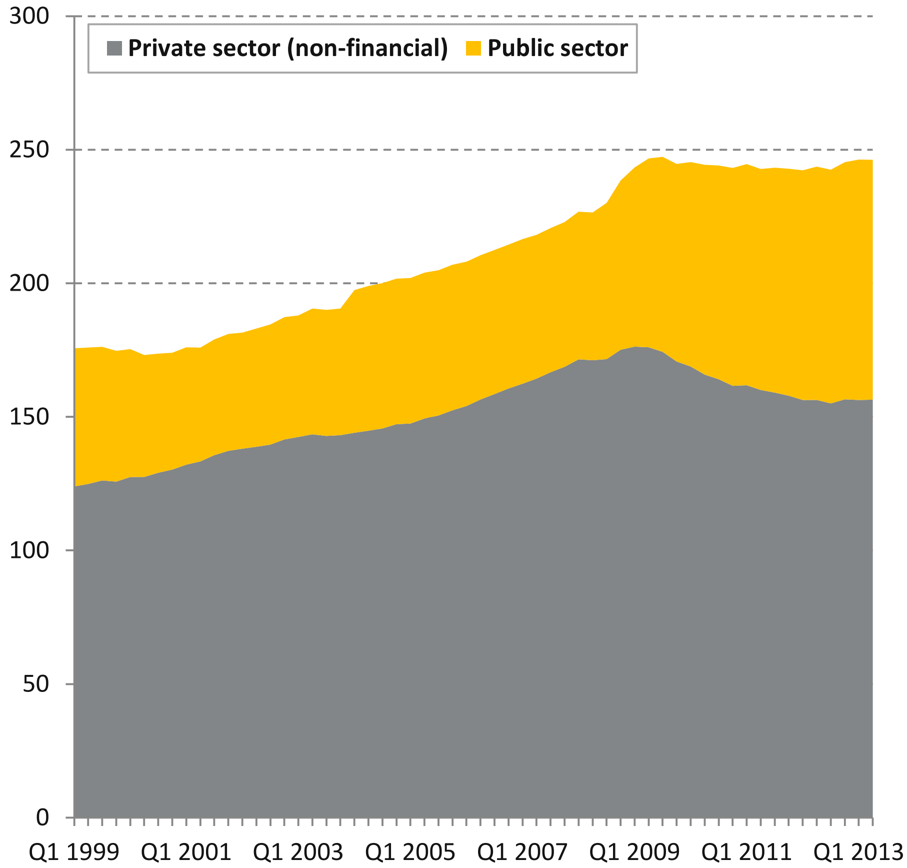
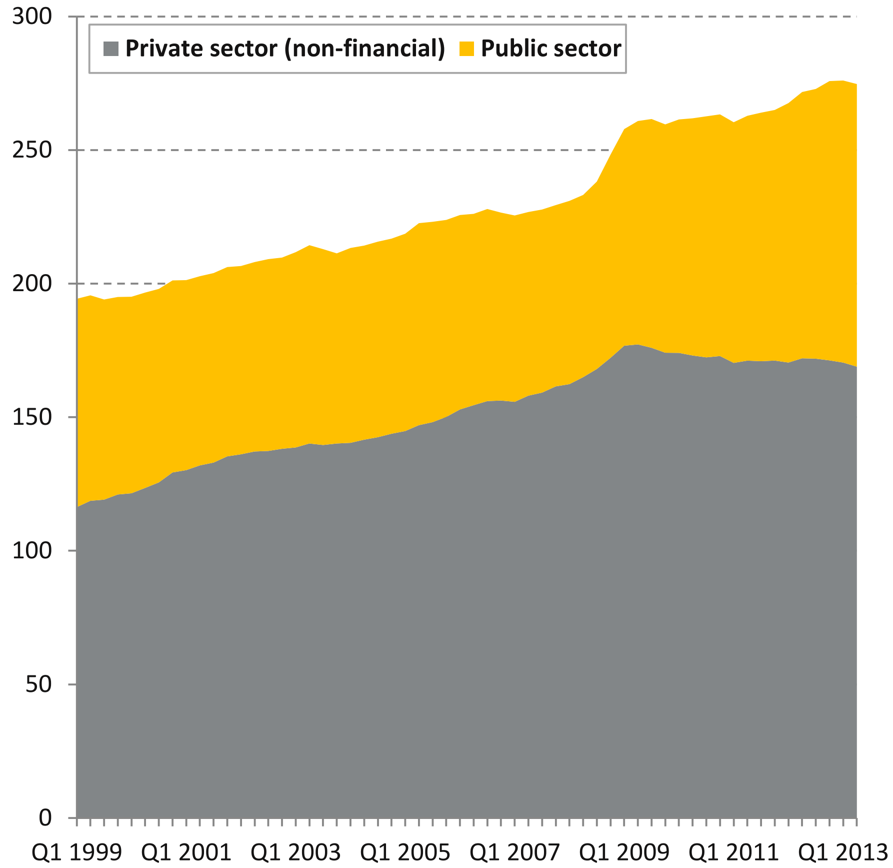
Private sector deleveraging

US

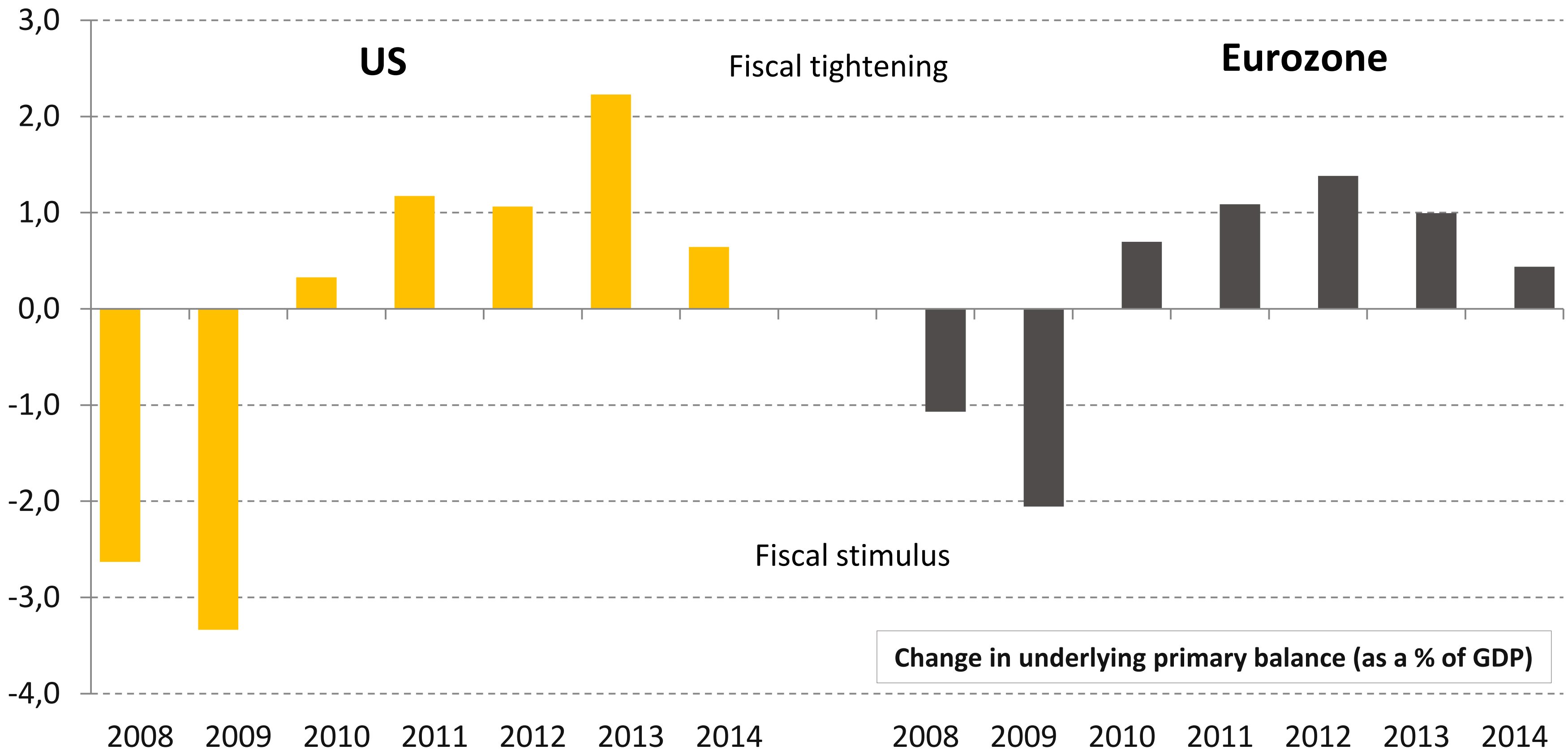


Europe

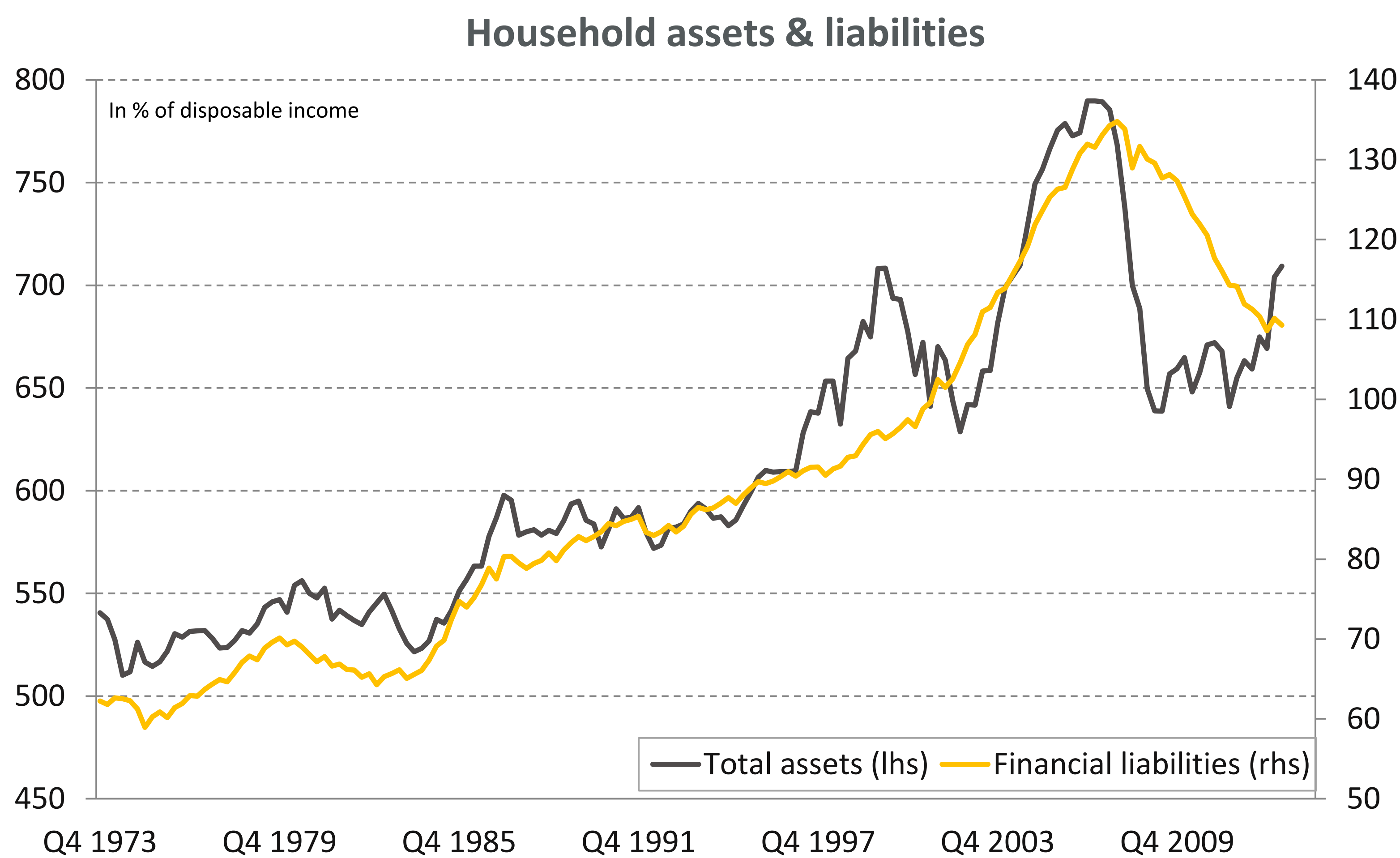


As a % of GDP

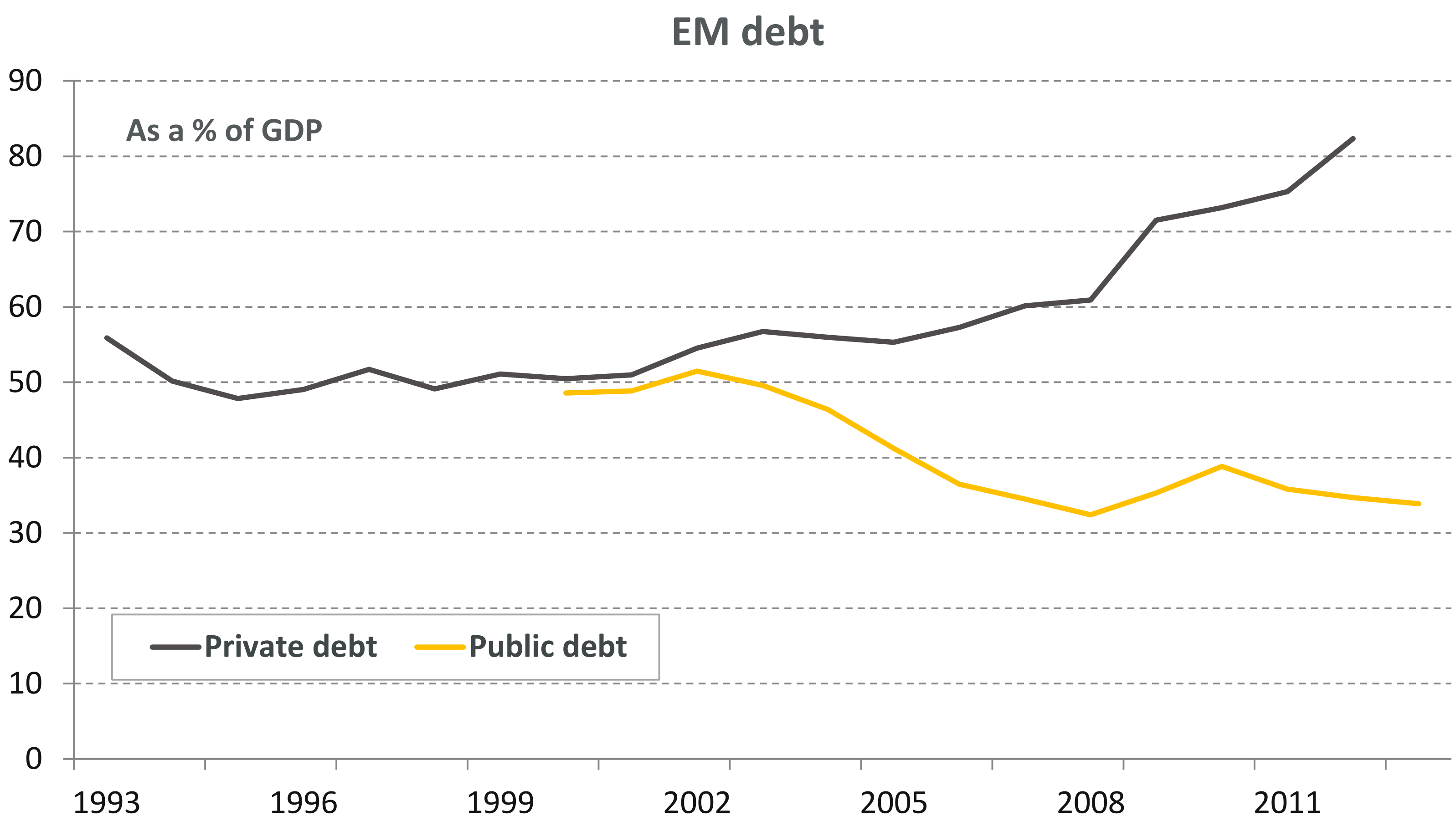
Less fiscal tightening in 2014



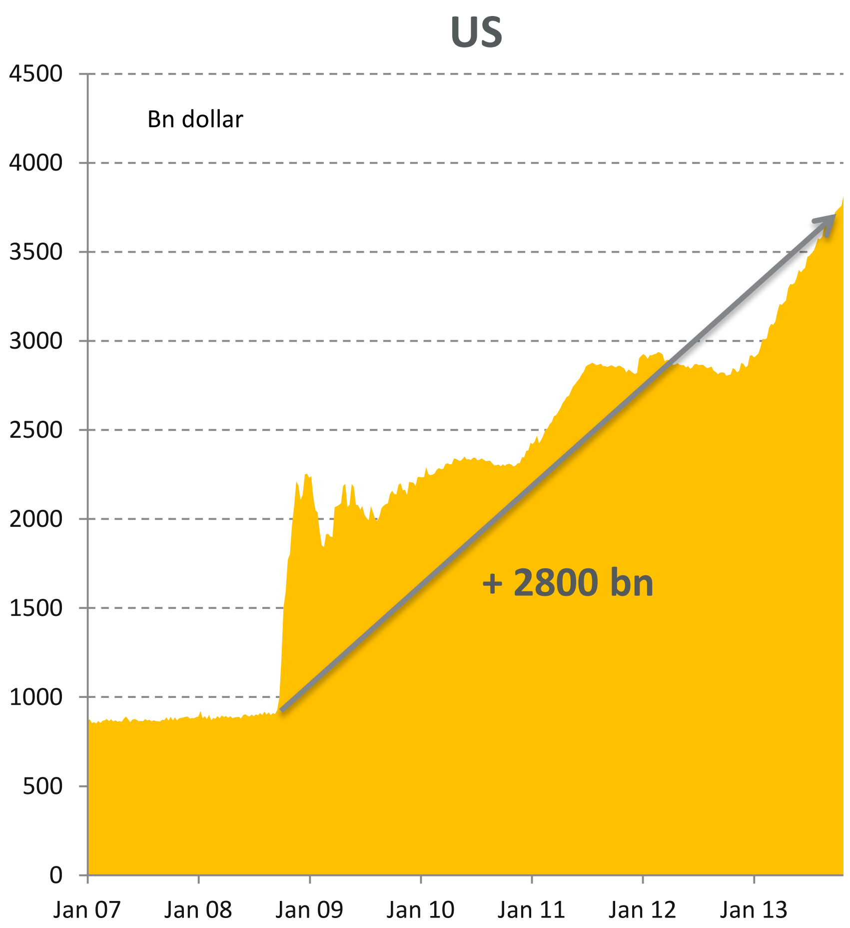
US households restore balance in finances

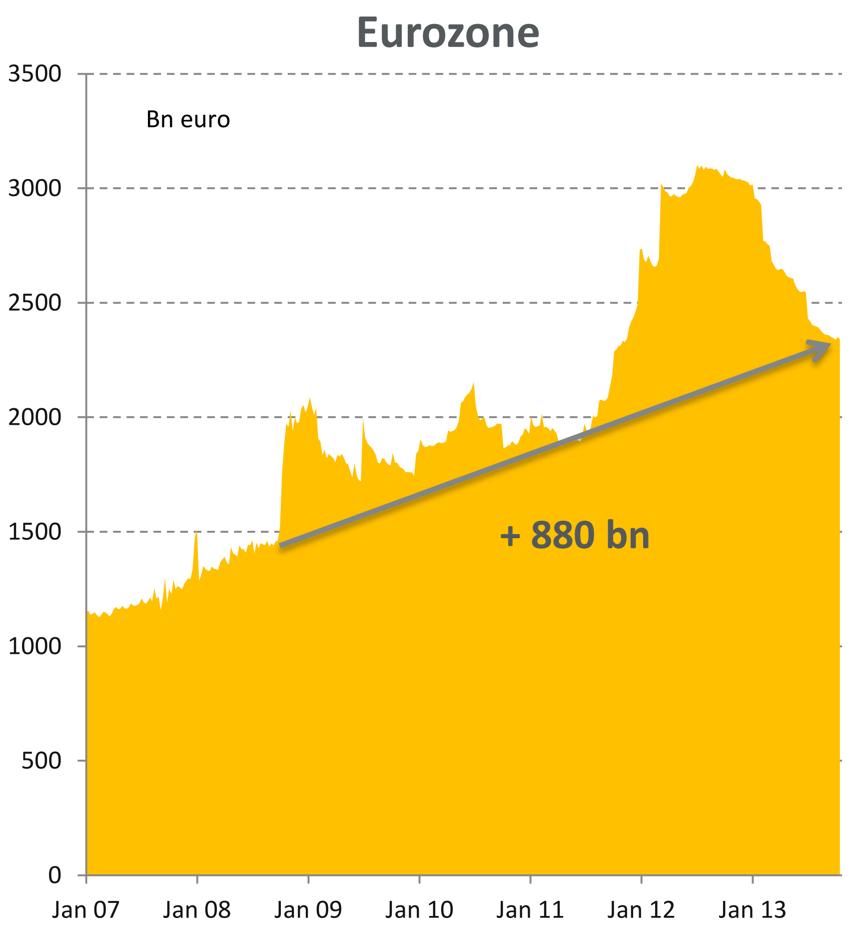


Looking for a slowdown in private credit growth in EM

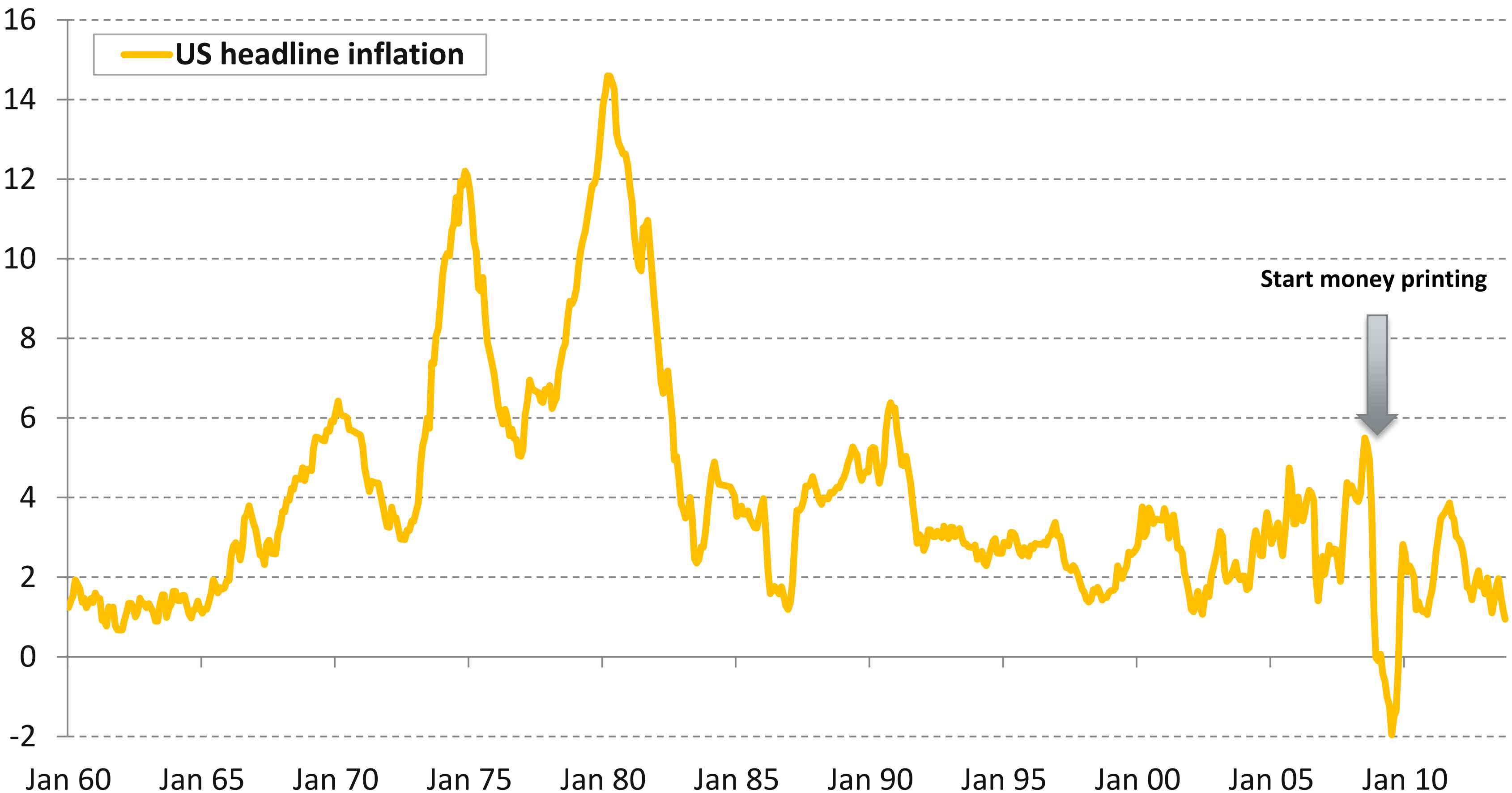


The printing press



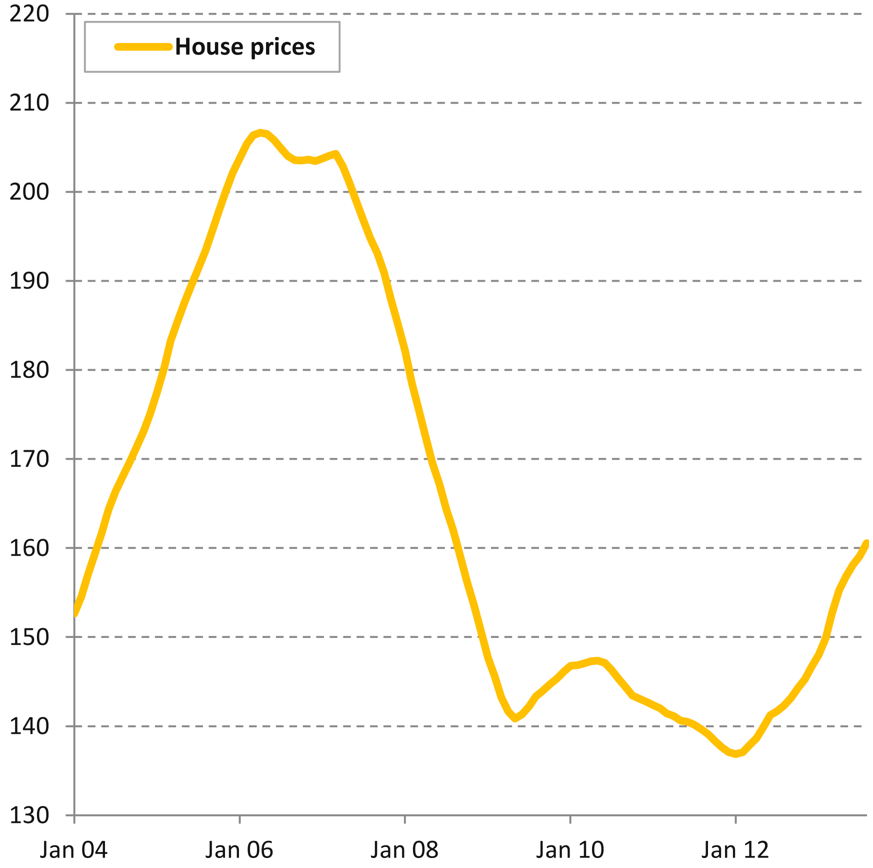


No inflation risk (for now)

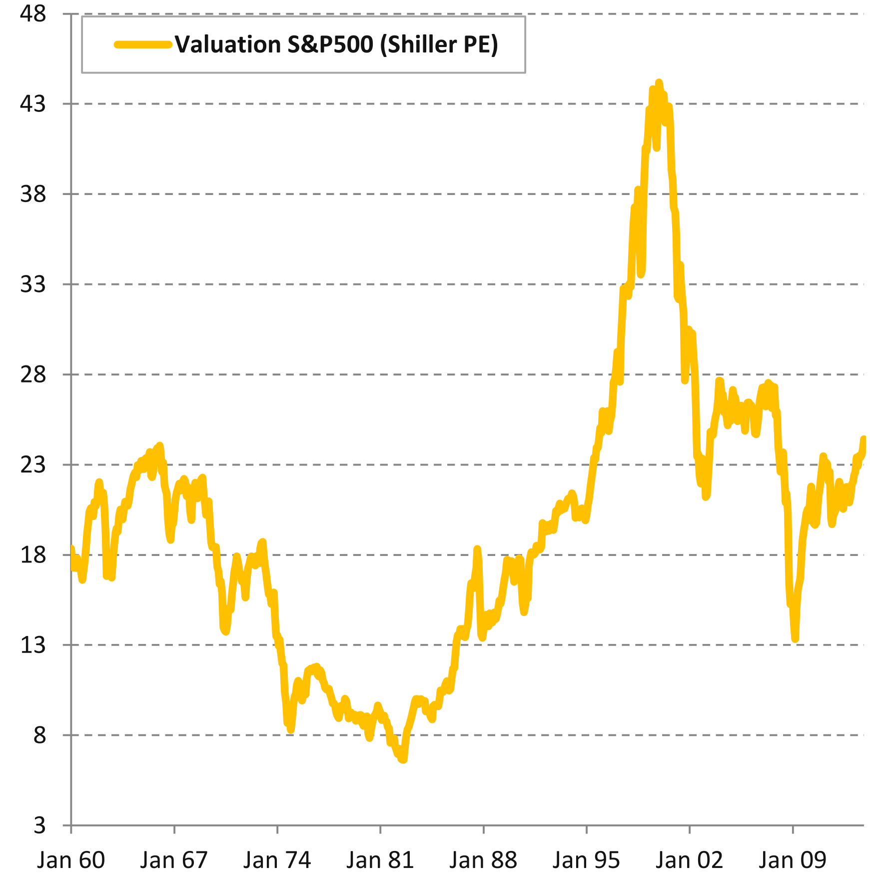


Bubbles?

Real estate



Equities

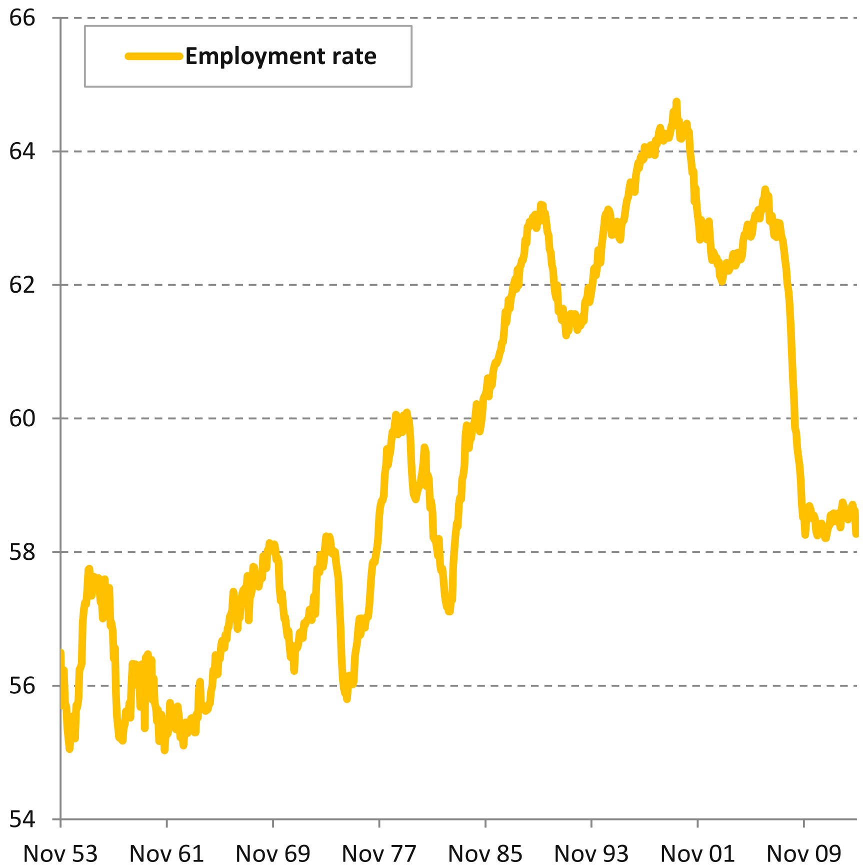


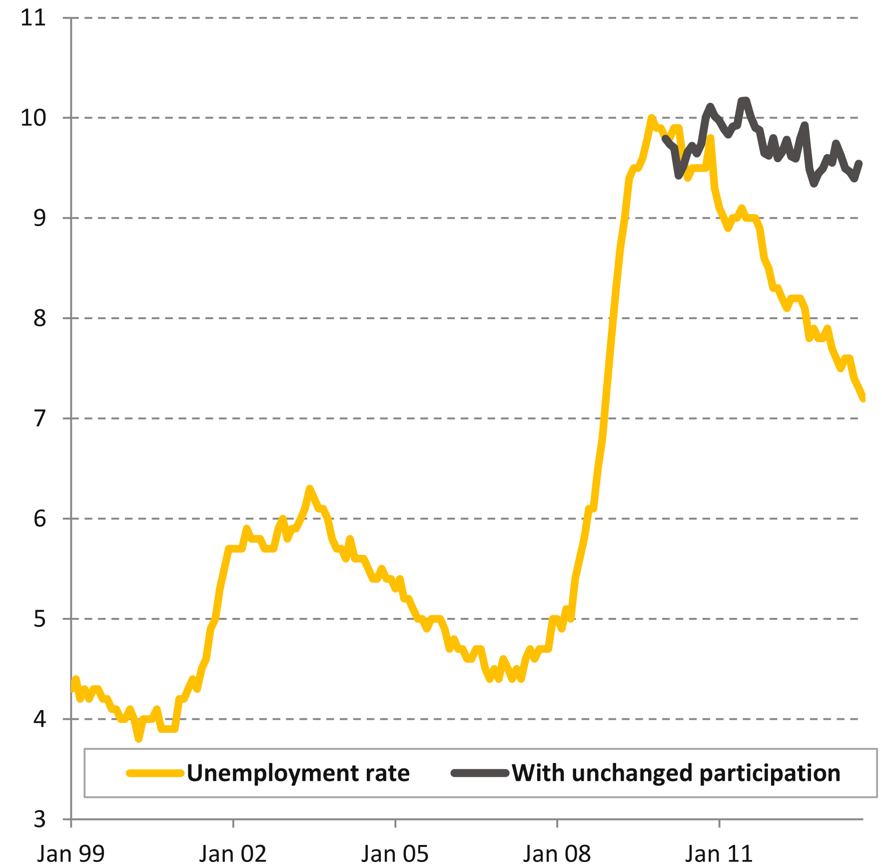
Recovery will push the Fed towards the exit

- Housing market recovery
- Household finances in better shape
- Improving labour market outlook
- Banking sector back to acceptable health

→ Reduced need for emergency policy

No hurry as labour market conditions remain weak





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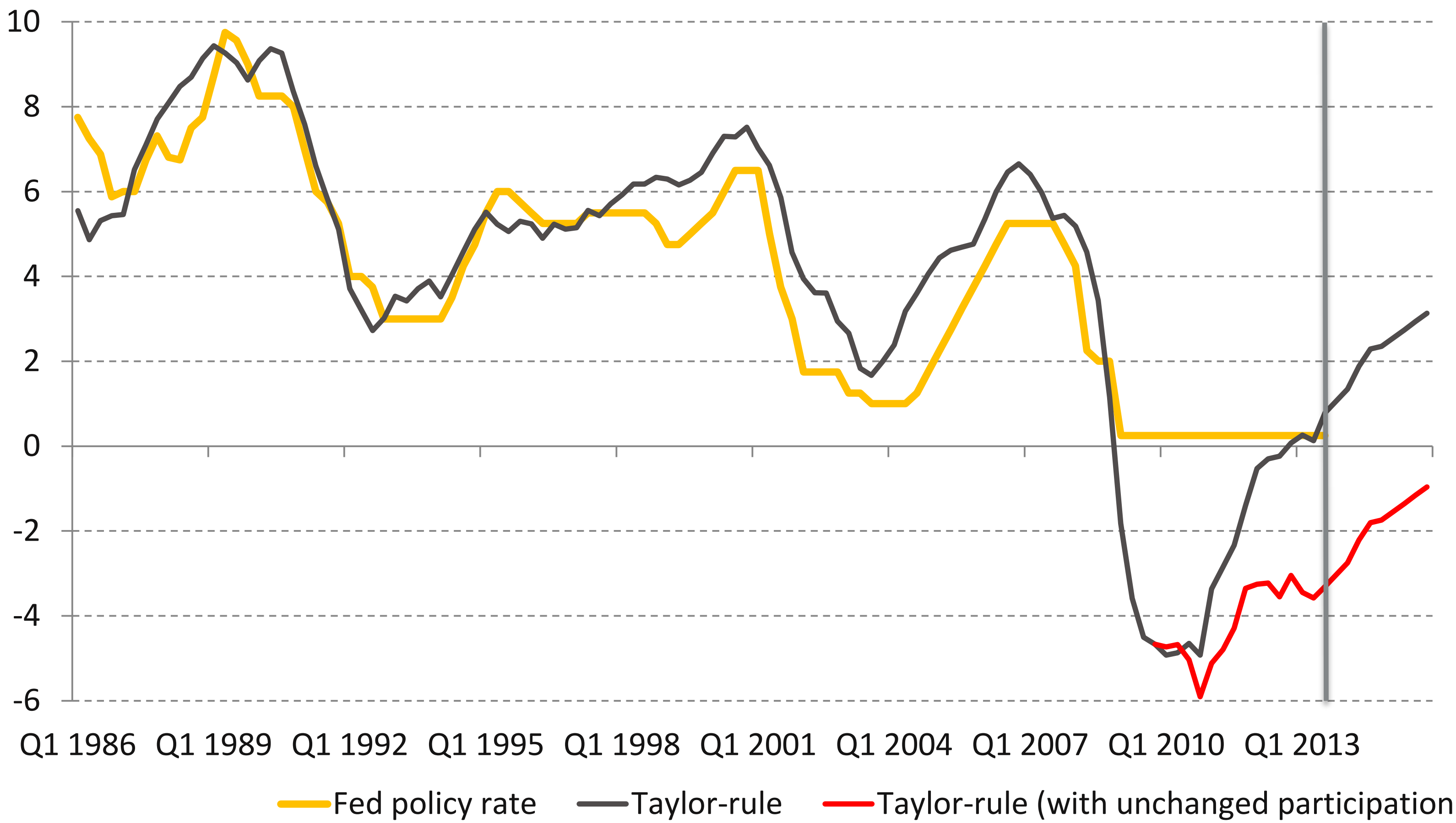
Fed taking a risk on higher inflation



Carefully managed turn in Fed policy

- Strengthening recovery
- Bubble risk

→ Turn in monetary policy

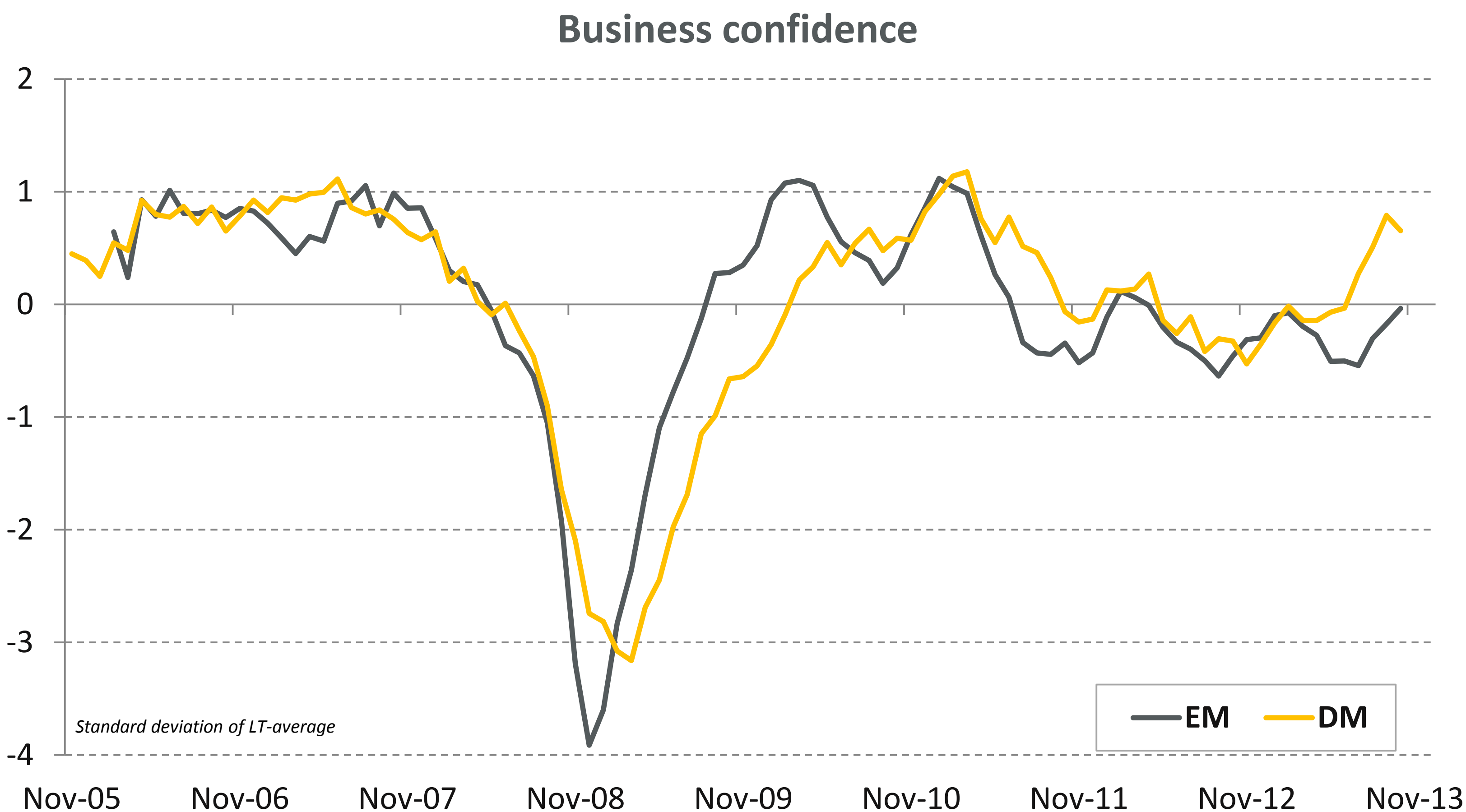
- Continued stop-start approach to limit impact on markets
- End of asset purchases + push out expectations of rate hike

→ Fed will not risk endangering the recovery

Upward risk for US yields limited


Recovery

Confidence is picking up



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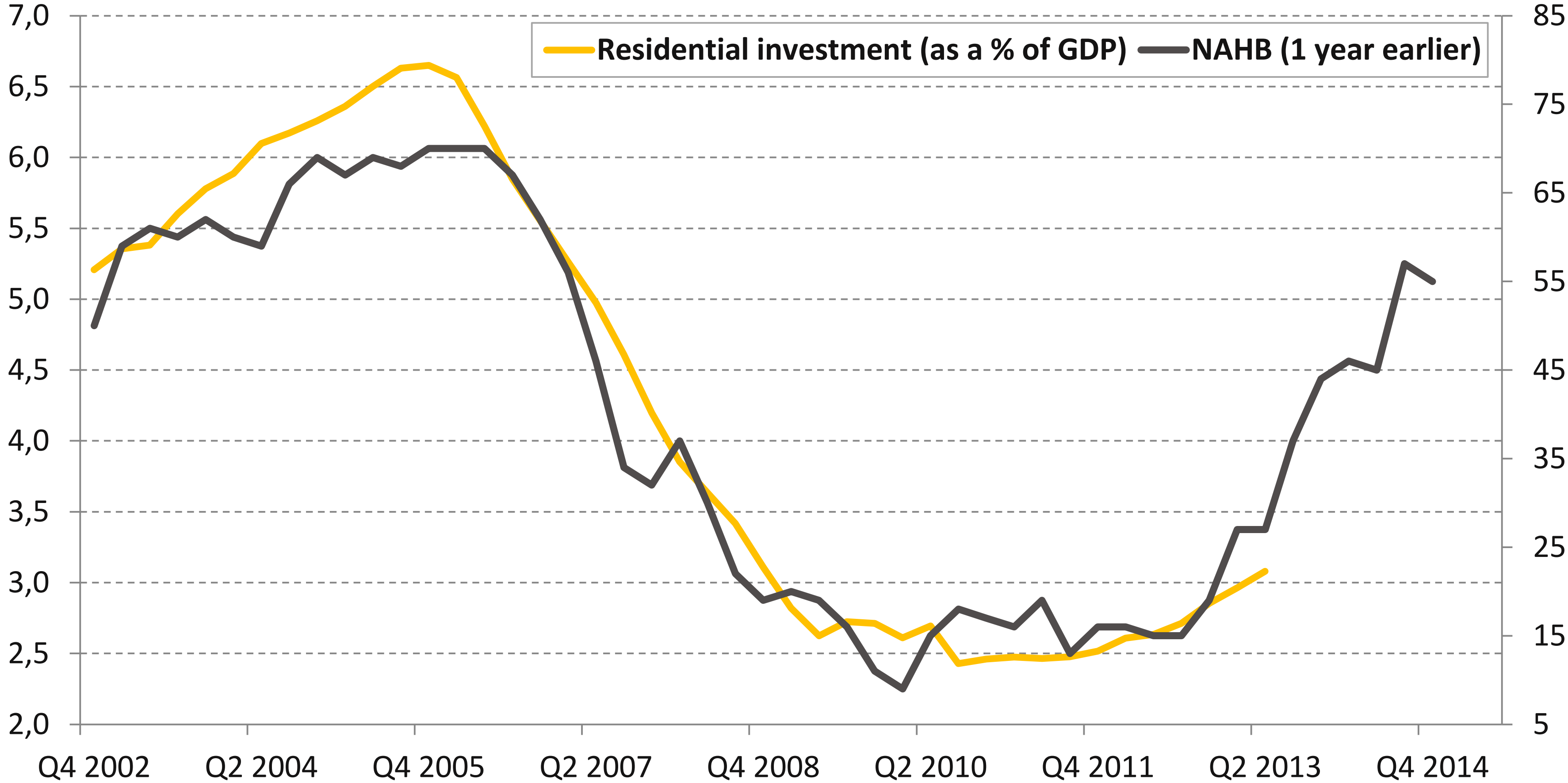
US housing recovery powering on



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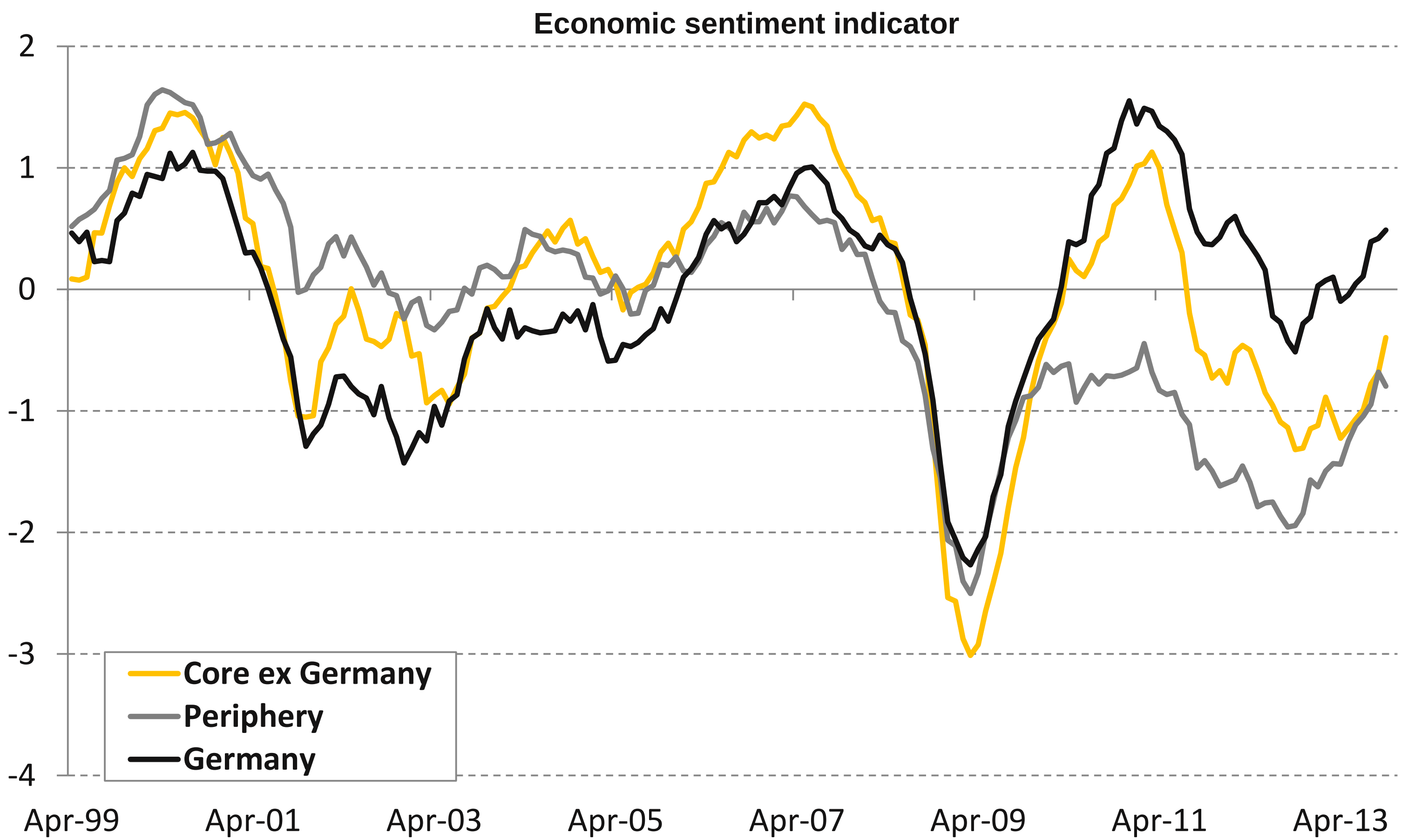
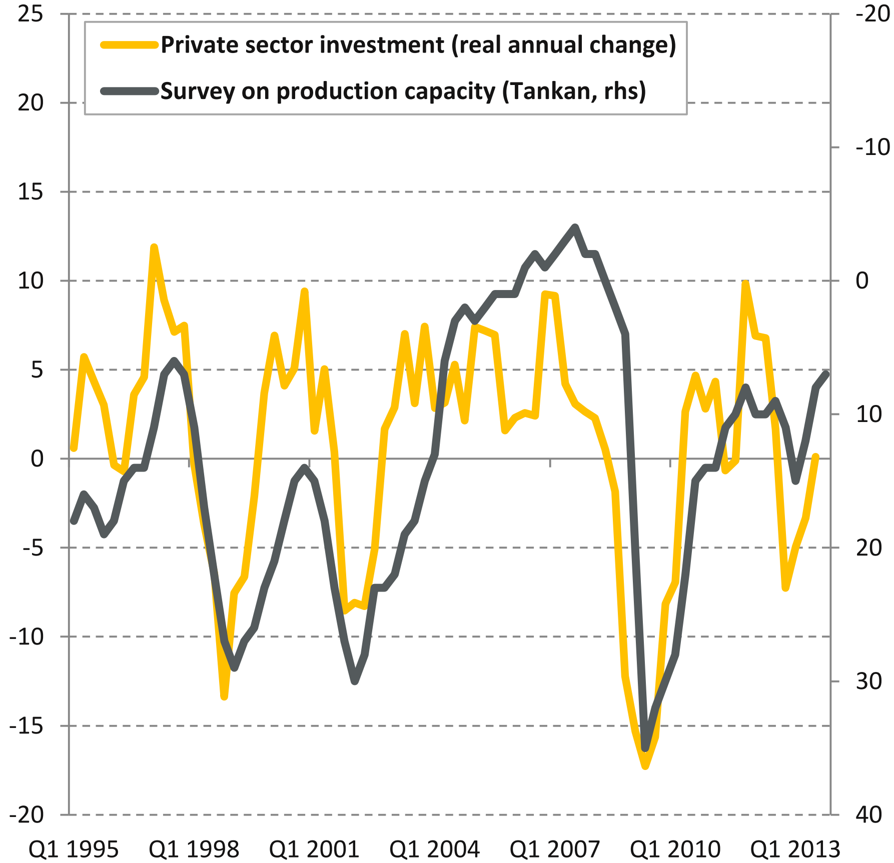
Broad-based improvement in economic sentiment



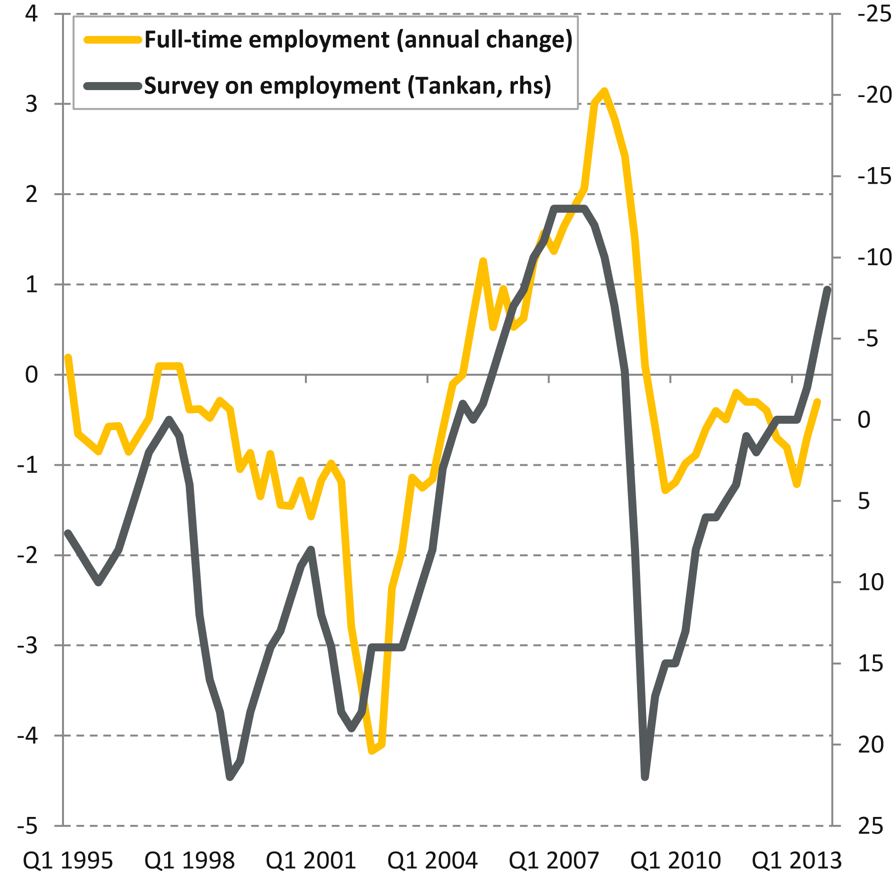

BANK
OF
JAPAN

Japanese companies ready to invest and hire

Capex



Employment



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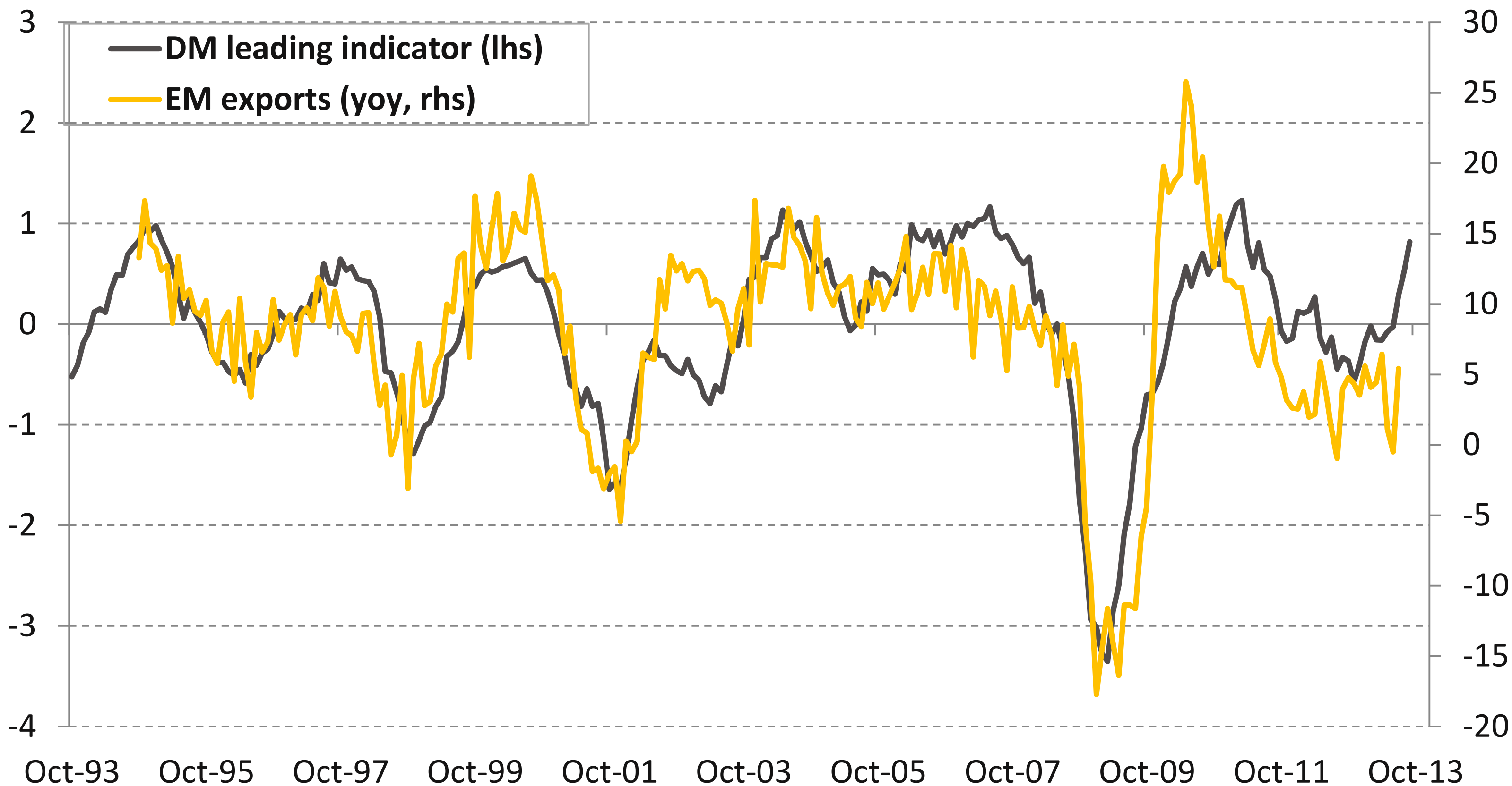
DM recovery should lift EM exports



2014 Outlook

- Activity: global recovery remains on track
- Inflation: remains firmly under control
- Policy: US moving to less easing, but overall monetary stance remains very supportive
- Fed key for financial markets

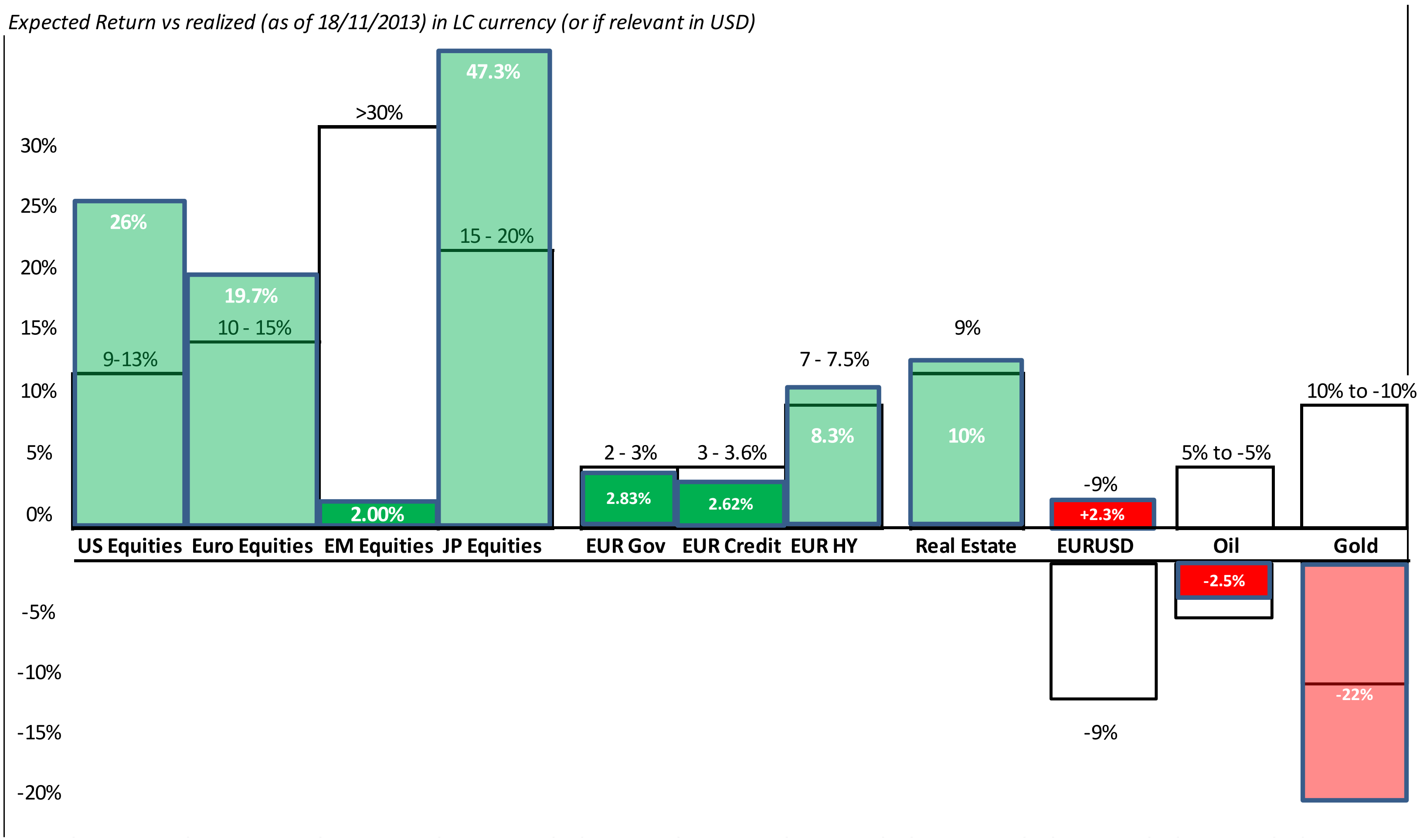
- Economic outlook 2014
  - Bart Van Craeynest – Chief Economist
- Global asset class outlook 2014
  - Maarten Geerdink – Chairman Asset Allocation Committee

Agenda

- **How did we do in 2013?**
- Key theme 2014
- Expected returns 2014 FIXED INCOME
- Expected returns 2014 EQUITIES
- Conclusions

Predictions 2013 vs Outcomes 2013 so far (18th of November 2013)

Expected Return vs realized (as of 18/11/2013) in LC currency (or if relevant in USD)



Equities: Performances in 2013

- **Emerging market equities look ready for a re-rating after a disappointing 2012. Expected performance > 30% if growth picks up and liquidity remains ample**
  - *Emerging market equities have not shown the performance we expected due to stagnating growth and the fear of a retraction of global liquidity during the summer of 2013*

- **Conditional to the JPY remaining weak, Japan could also provide an attractive return > 15%**
  - *JPY remained weak and Japanese equities delivered very strong returns*

- **Even though the European economy doesn't really recover, earnings will grow and P/E should see small expansions. This leads to a return of >10%**
  - *P/E's have rerated (significantly) but earnings growth has not come through yet. European equities delivered a strong performance*

- **The US probably incorporated much of the expected growth in its multiples already. Still, a healthy 10% return can be expected**
  - *Further P/E expansion and decent earnings growth have propelled US equities further up then we expected*

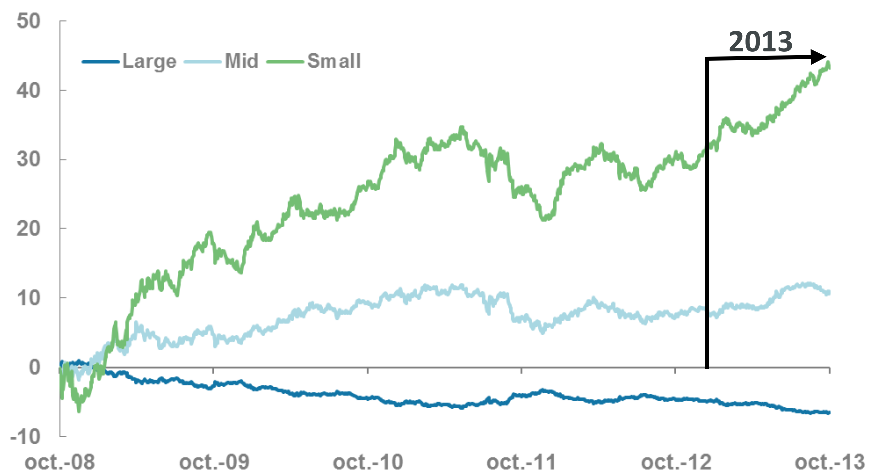
3 Equity themes that we highlighted in 2013

- **Pick up in Merger and Acquisitions can drive markets higher**
  - *Not yet, but IPO's and placements have picked up significantly*

- **Style Performance:**

Value is likely to outperform growth

Small caps will outperform large caps



Bonds: Government bonds performance in 2013

- **Slightly better economic conditions and less existential worries warrant higher core rates**
  - *This drove periphery yields tighter*
- **But, no strong recovery in Europe, so increases remain subdued**
  - *German yields indeed rose (by about 35bps) but the rise remained controlled*
- **Peripheral should benefit from further spread contraction, but not significantly since worries remain**
  - *Worries actually disappeared relatively quickly this year*
- **Main source of return is the coupon**
  - *But also roll-down contributed to return due to steepness of curve (80bps)*
- **Slow path to rate normalization as ECB keeps rates low for longer**
  - *The ECB actually cut rates twice this year to an all time low of 0.25%*

Bonds: Credit & High Yield performance in 2013

- **European corporate IG Credit to tighten 10 to 25 bps**
  - *Corporate credit actually performed better with the ITRAXX Main tightening 30 bps*

- **European High yield to tighten 10 to 25 bps**
  - *High Yield actually performed better with the ITRAXX Cross over tightening 130bps*

- **Especially corporate High Yield performed well in 2013**

Other asset classes: performance in 2013

- **Real Estate**
  - *Performance inline with expectations*

- **EURUSD**
  - *EUR did not weaken as we expected due to better then expected macro data in Europe and the FED postponing the reduction in LSAP (Large Scale Asset Purchase program or QE)*

- **Gold**
  - *Gold fell from grace on the back of tamed inflation expectations, less existential threats in Europe and a multi-year bull market*

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KEY THEME 2014: How much rate pressure can financial assets handle?

- **FED is the only show in town?**
  - *Assuming our macro scenario, the biggest unknown is the reaction of markets to eventually less monetary stimulus from the FED*

- **Bond markets**
  - *What is the bond market expecting in terms of interest rates? How much can rates rise before total returns become negative?*

- **Equity markets**
  - *Valuations have risen strongly in anticipation of growth; how much more can we expect? How strong will earnings grow in 2014?*
  - *What will be the impact of potential higher interest rates on equity valuations?*

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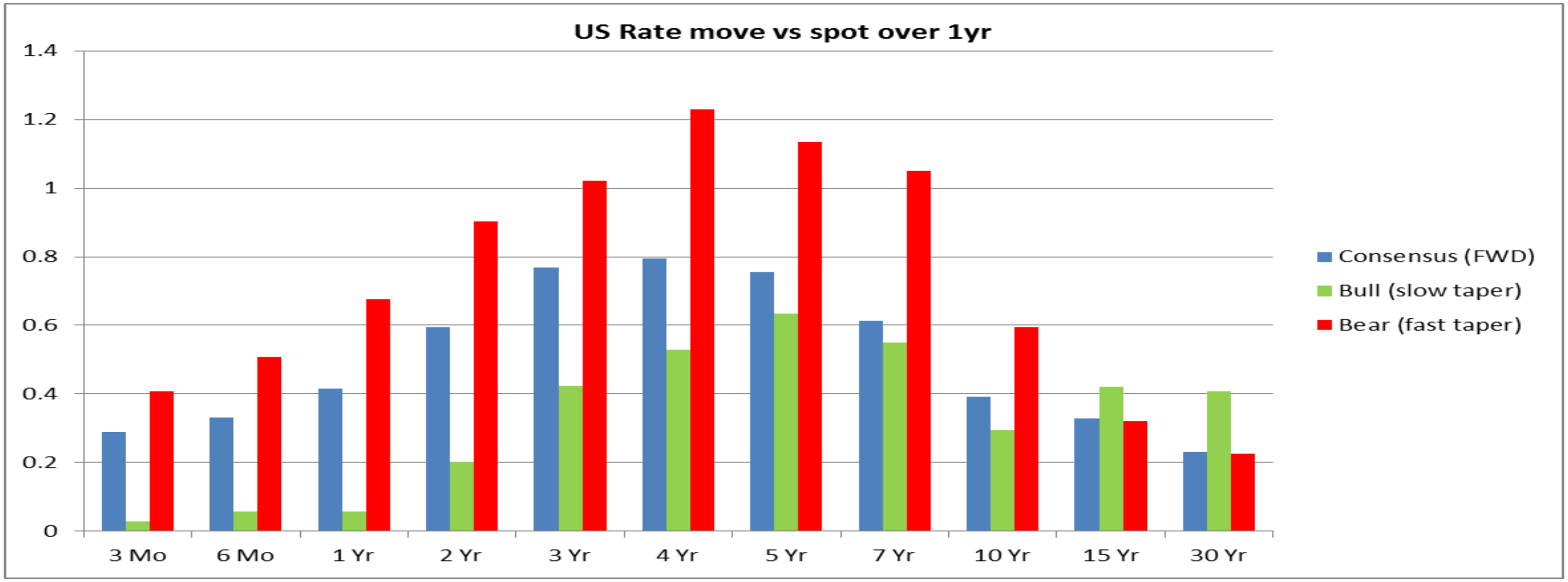
Expected returns 2014 – US Government bonds

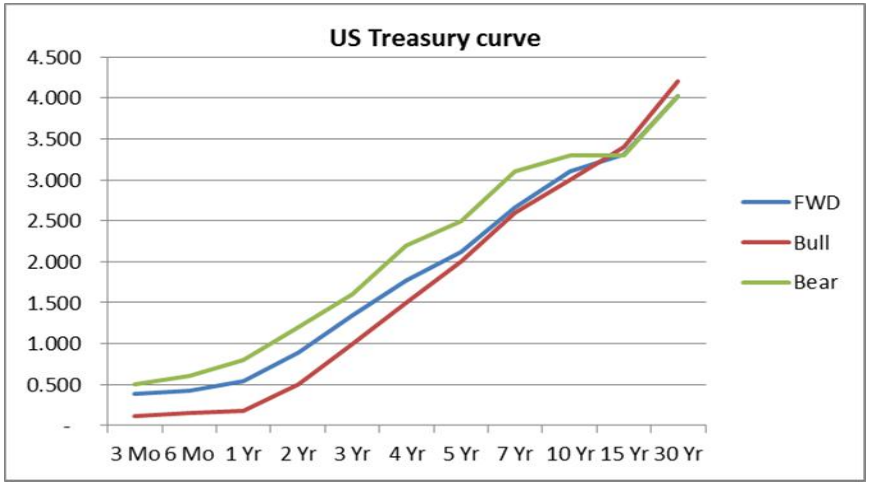
- Our scenario: rates will move according to current forward rates (blue scenario); tapering is actively managed
- Bull case: the FED tapers later then markets expect limiting rate pressure on the front end of the curve (green scenario)
- Bear case: the FED tapers more aggressively, pushing up the front end and belly of the curve (red scenario)

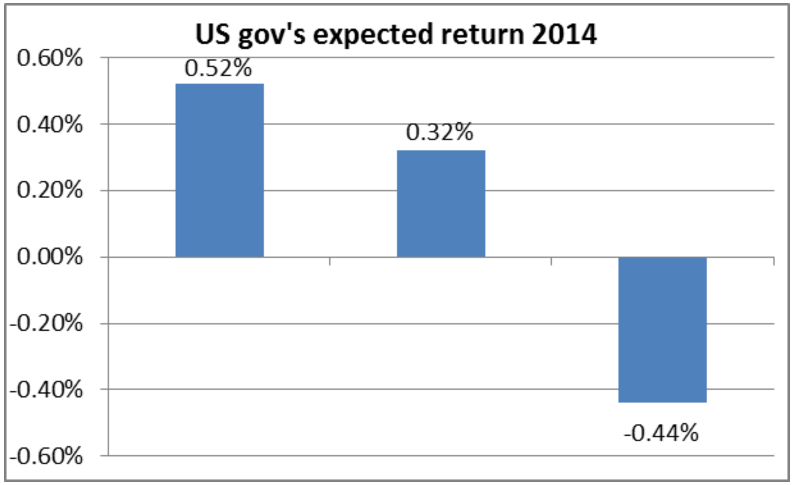


Expected returns 2014 – US Government bonds

US Government bonds			
	Bull case	Base case	Bear case
Yield to worst	*slower taper*	*FWD curve*	*Faster taper*
1.40%	0.52%	0.32%	-0.44%

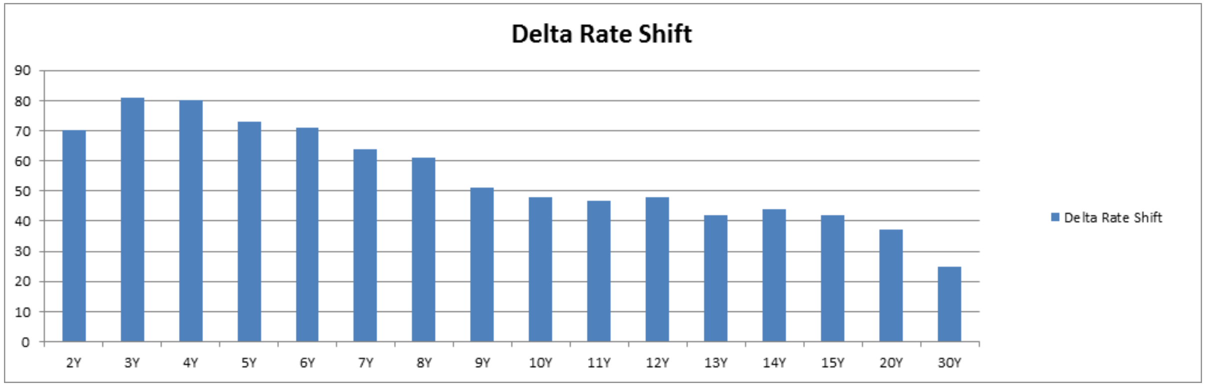
- Marginal positive returns in market implied scenario
- Upside limited, as is downside

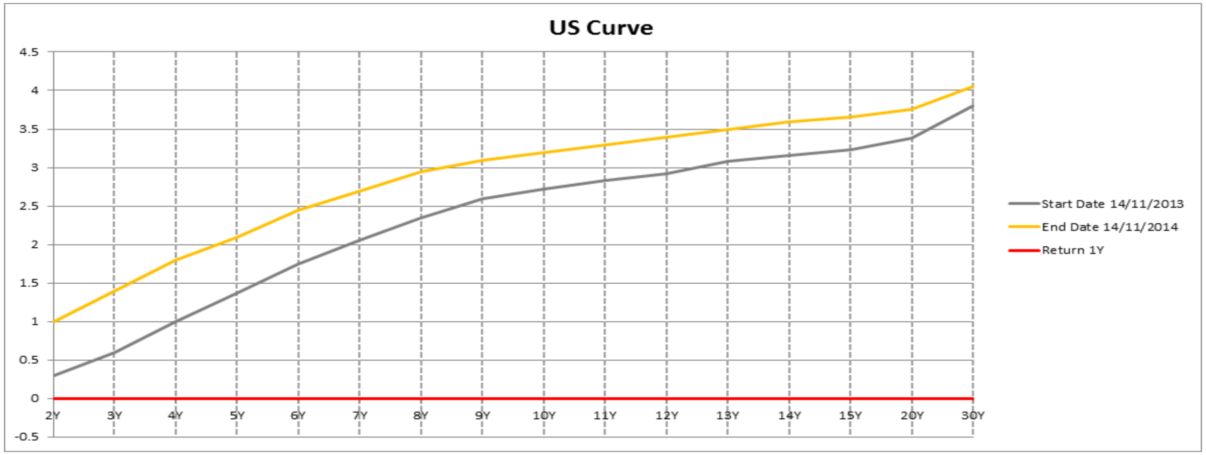




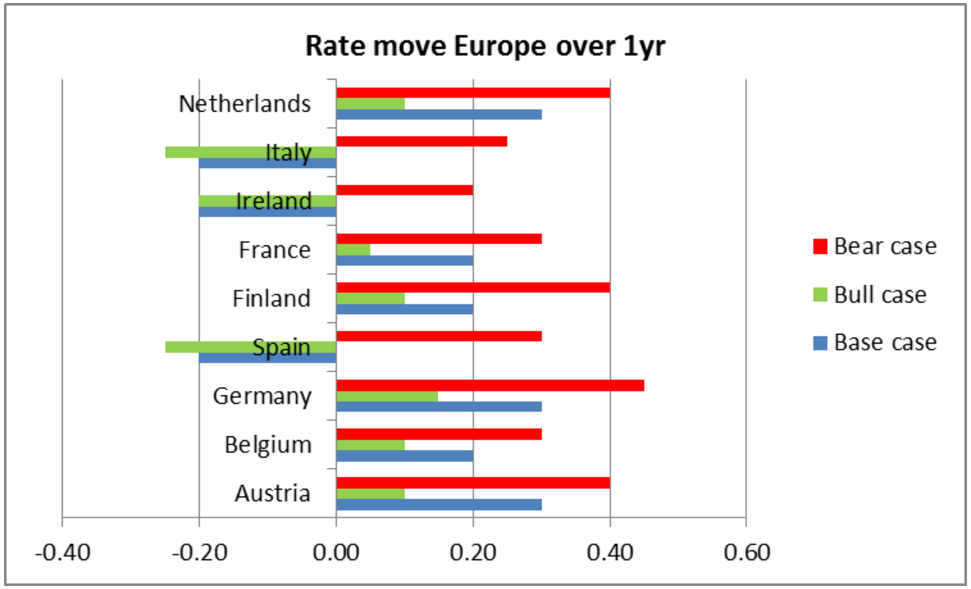
Expected returns 2014 – how much can rates rise before you lose money?

Roll down and yield return helps to compensate for rate rise





Expected returns 2014 – European Government Bonds

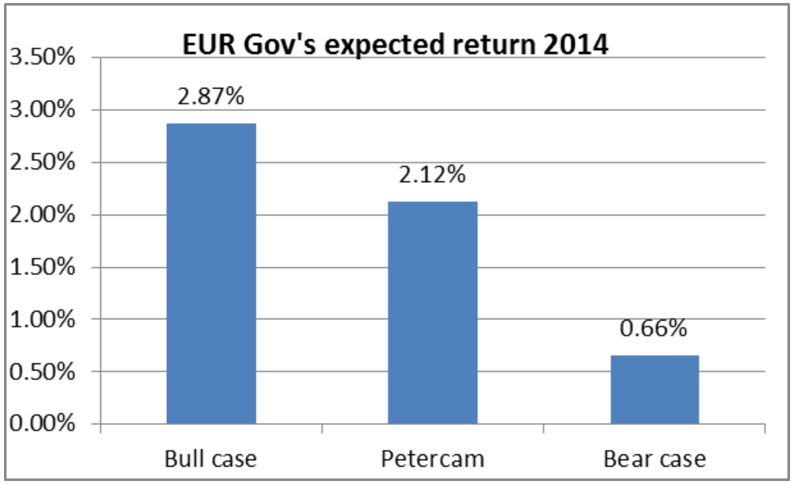


- Spread view still dominant
- Base case assumes further tightening between core rates and periphery
- Bull case limits upside pressure on core rates
- Bear case pushes up core and periphery rates

Expected returns 2014 – European Government Bonds

EUR Government bonds			
Yield to worst	Bull case *rates rise limited*	Base case *Spreads narrow*	Bear case *Rates rise across EUR*
1.99%	2.87%	2.12%	0.66%

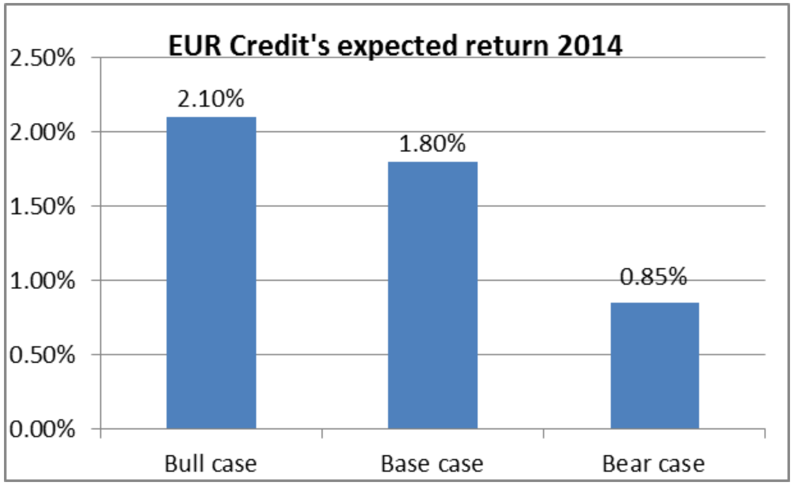
- Petercam goes for Base Case in 2014
- Roll down and Yield are still attractive (roll down 0.78%)
- Sensitive to rates rising in the US (FED taper)
- ECB needs to step up intervention to prevent "spill-over" from US



Expected returns 2014 – European Investment Grade Credit

European Credit (taking our rates scenario into account)			
	Bull case	Base case	Bear case
Yield to worst	*10 bps tightening*	*0 bps*	*15 bps widening*
1.96%	2.10%	1.80%	0.85%

- Our scenario: spreads remain stable (base case)
- Consequence is a small positive return on the back of rising rates scenario
- Bear case in spreads caused by deteriorating economic sentiment
- Bull case in spreads is driven by further improvement in economic sentiment



Managers' message: our positioning in IG Credit

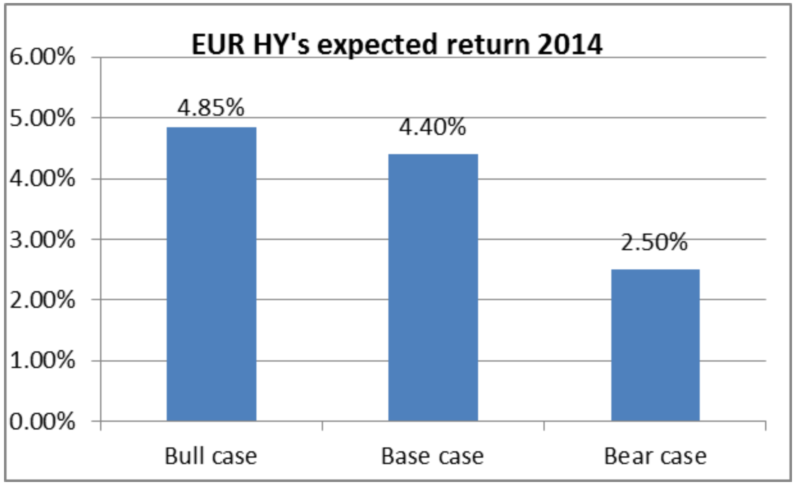
- Institutional demand for IG credit remains intact as the fixed income asset class adapts and accepts an environment where financial repression conditions are sustained and anchored (in order to allow slow deleveraging of indebted DM) – 2014 will see high redemptions and prudent issuance.
- Within European IG credit we prefer to select high quality corporate bonds with longer maturities and combine those with a limited selection of medium term subordinated bonds of high quality corporates as well
- This portfolio construction allows to offer investors a risk controlled yield pick-up versus our European reference universe (Iboxx)

CORPORATE SENIOR BONDS (90% to 85% of portfolio)				CORPORATE SUBORDINATED BONDS (10% to 15% of portfolio)			
	Name	YTM	Rating		Name	YTC	Rating
Non-Financials	Deutsche Telecom 3.25% JAN 2028	3.11%	BBB+	Non-Financials	GdF Suez 3.875% Var 49- JUL 2018	3.16%	BBB+
	Robert Bosch 2.62% APR 2028	2.78%	AA-		EDF 4.25% Var 49 - JAN 2020	3.71%	BBB+
	Elia 3.25% APR 2028	3.18%	A-		Hutchison Whampoa 3.75%% Var 49 - MAY 2018	4.51%	BBB
	Siemens 2.875% MAR 2028	2.91%	A+		AMERICA MOVIL 5.125% Var 73 - SEP 2018	4.40%	BBB
Financials	BNPP 2.875% OCT 2022	2.67%	A+	Financials	Rabobank 3.875% JUL 2023	3.67%	A+
	JPMorgan 2.75% FEB 2023	2.73%	A		Barclays 6.625% MAR 2022	4.05%	BBB
	Goldman Sachs 3.25% FEB 2023	2.98%	A-		AXA 5.125% Var 2043-2023	4.05%	BBB+
	KBC 2.125% SEP 2018	1.62%	A-		Hannover Re 5.00% Var 2043-2023	4.00%	A-

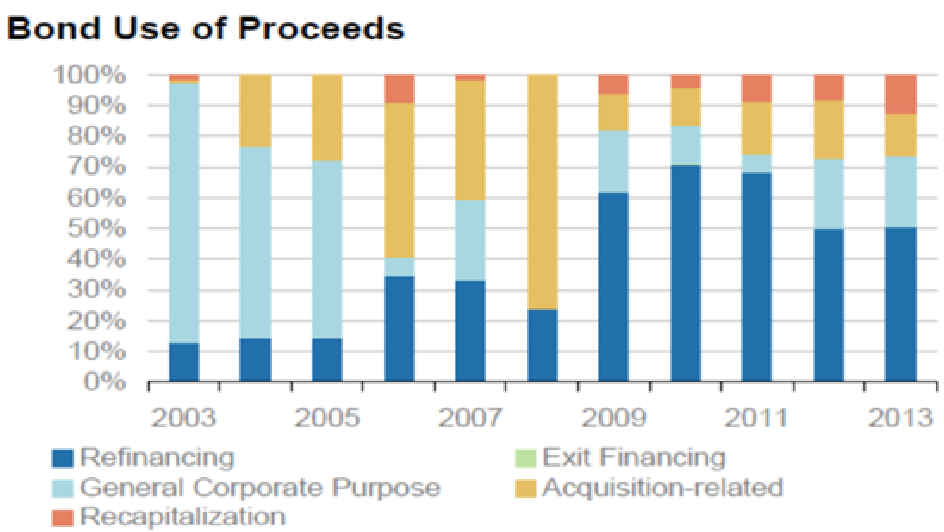
Expected returns 2014 – European High Yield

European High Yield (taking our rates scenario into account)			
	Bull case	Base case	Bear case
Yield to worst	*20 bps tightening*	*0 bps*	*40 bps widening*
4.53%	4.85%	4.40%	2.50%

- Our scenario: spreads remain stable
- Returns will be close to the expected yield
- Bear case could be caused by deteriorating economic sentiment
- Extra source of return will be limited given that most bonds are trading near their call price.



Managers message: Stable outlook



Source: Morgan Stanley Research, LCDComps, Dealogic

- The outlook broadly similar to 2013; default rates should remain low (1.5% estimated) and corporates should continue to refinance the balance sheet well in advance of their maturity shedule.
- Few alternatives exist in the fixed income market that offer yields above 4%. High yield market should continue to expand its investor base and attract new institutional money.
- Our portfolio strategy is to take on additional default risk premium through a selectcion of B corporate bonds with longer maturities and to combine this selection by being underexposed to interest rate risk with a limited selection of shorter maturities in the BB category.

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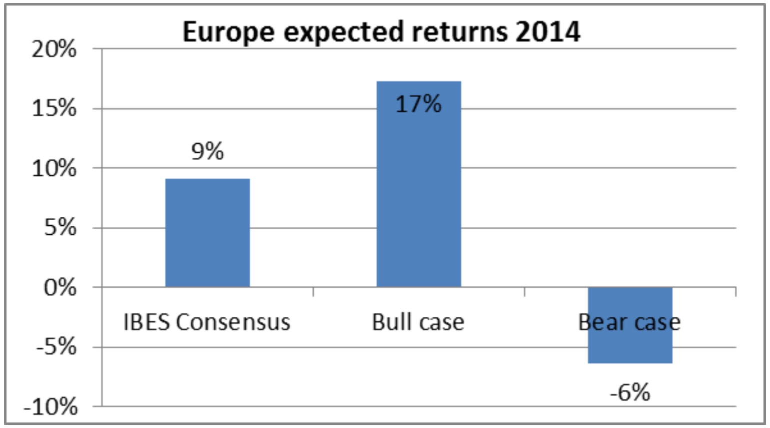
Expected returns 2014 – European Equities

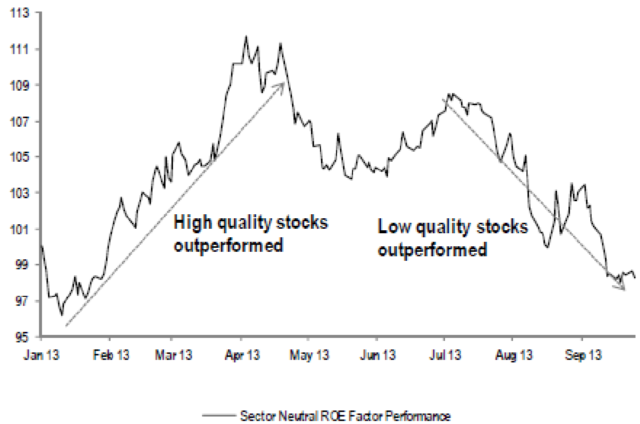
MSCI Europe	Implied growth rate		Earnings	Multiple	Dividend
Current		2013	92	16.3	3.46%
IBES Consensus	12.6%	2014e	103	15.3	3.46%
Bull case	16.0%	2014e	106	16	3.46%
Bear case	5.0%	2014e	96	14	3.46%

- We are a bit more optimistic on earnings growth then consensus
- Companies will be the winners of economic growth (no pricing power for labor)
- Therefore some additional revenue will directly translate in better earnings
- The bear case incorporates another year of disappointing earnings in Europe, which will trigger a multiple downgrade



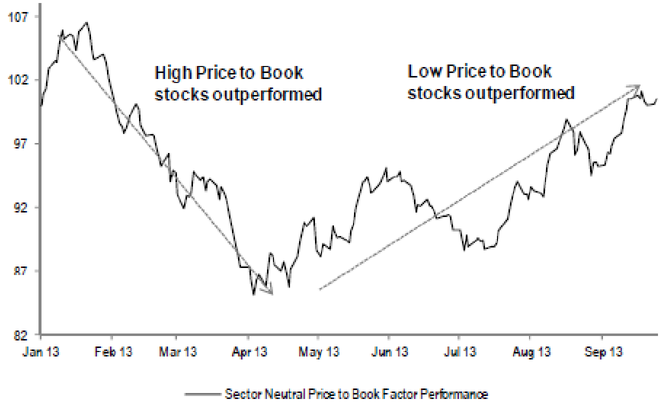
Managers message: It's all about ***middle of the pack***, not quality or growth

Quality (High vs Low ROE) factor performance ytd



Source: J.P. Morgan, relative performance of top decile of MSCI Europe stocks with highest ROE vs bottom decile, based on sector neutral constituents

Value (Low vs High P/Book) factor performance ytd

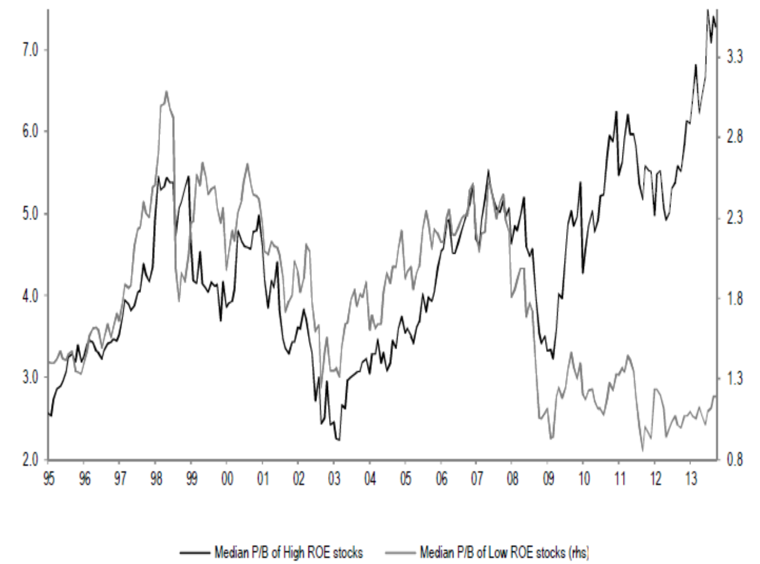


Source: J.P. Morgan, relative performance of top decile of MSCI Europe stocks with lowest P/Book vs bottom decile, based on sector neutral constituents

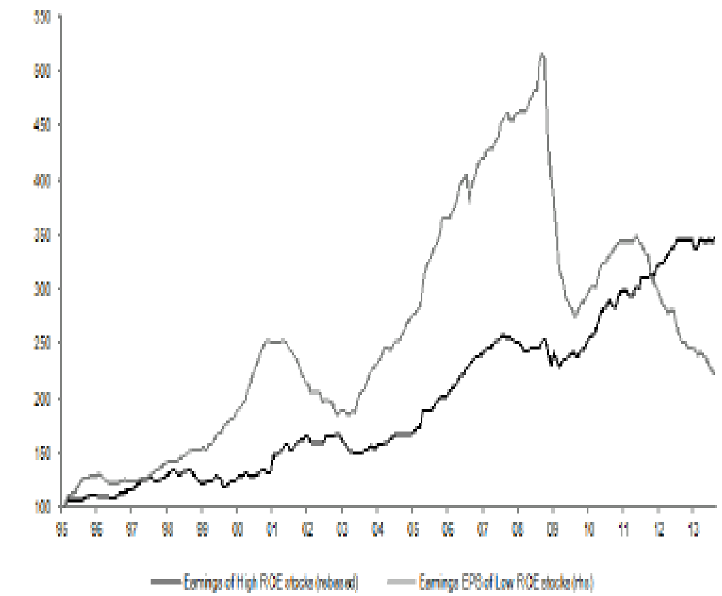
- The extremes have rerated, its time for the stocks in the middle to outperform

Managers message: Invest in FCF generators with cyclical upside potential

Figure 2: P/Book of high vs low ROE stocks in MSCI Europe



Source: Datastream

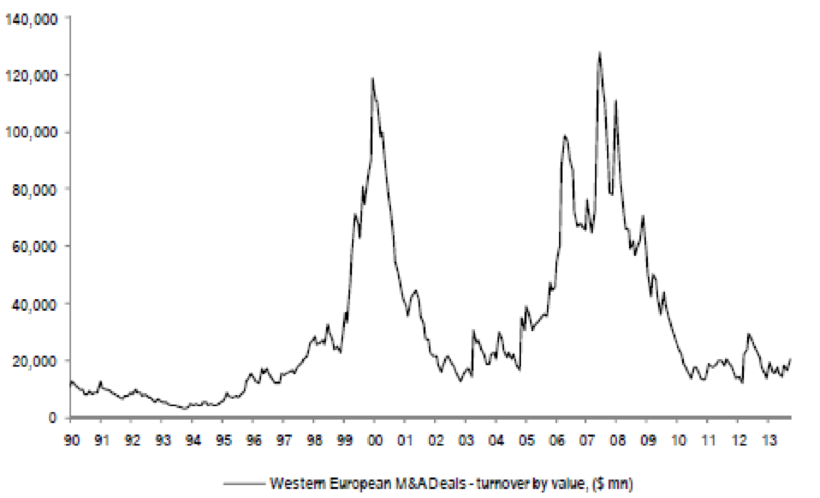


Source: J.P. Morgan, based on sector neutral constituents

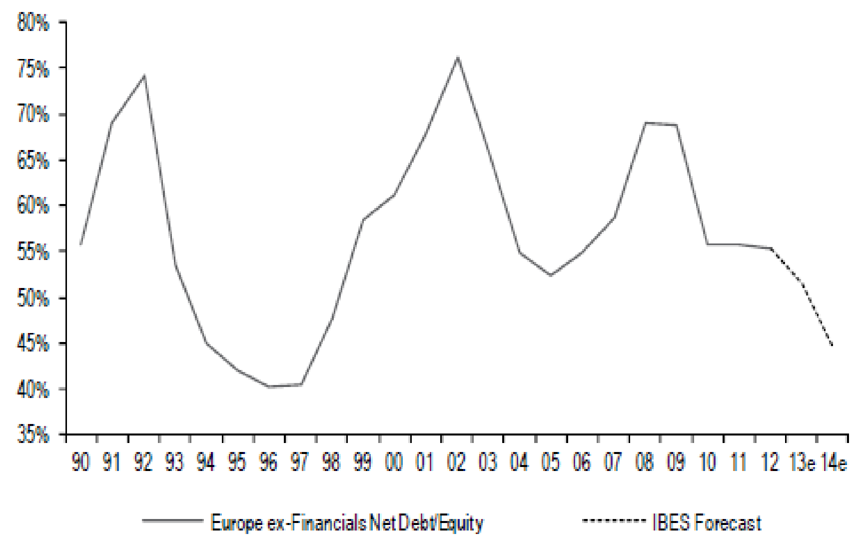
- Examples: Arcelor Mittal, CRH or JC Decaux
- Very different companies but all capable of converting revenue increases into cash flow improvements

Managers message: M&A still a theme to watch, pristine balance sheets!

Western European M&A activity



MSCI Europe Net Debt to Equity



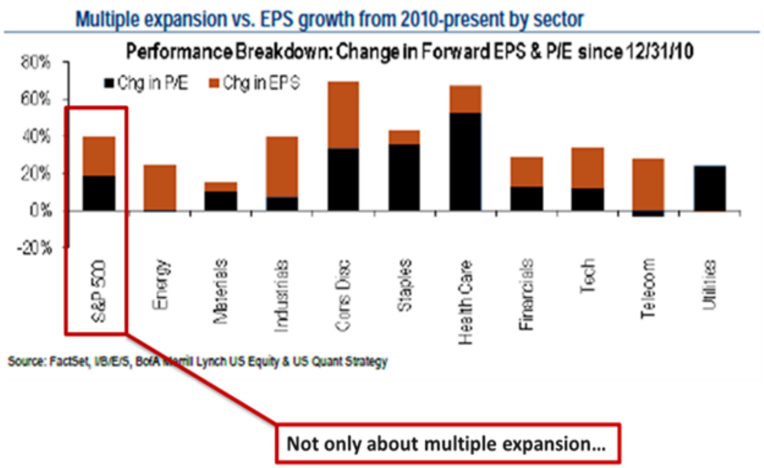
Source: Datastream

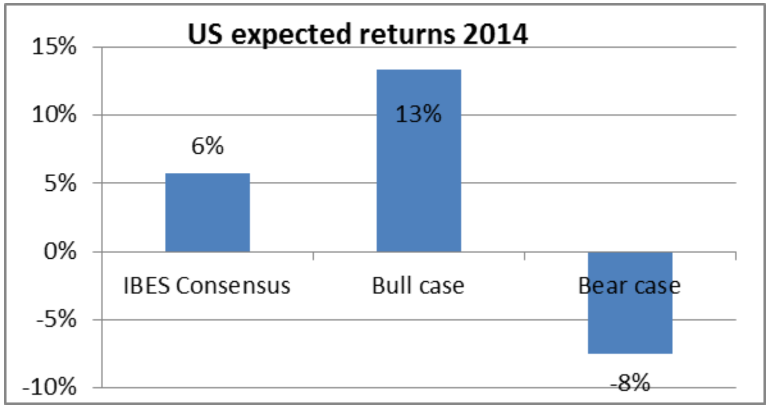
- M&A levels have hardly picked up
- But balance sheets are very healthy and ready to be used

Expected returns 2014 – US Equities

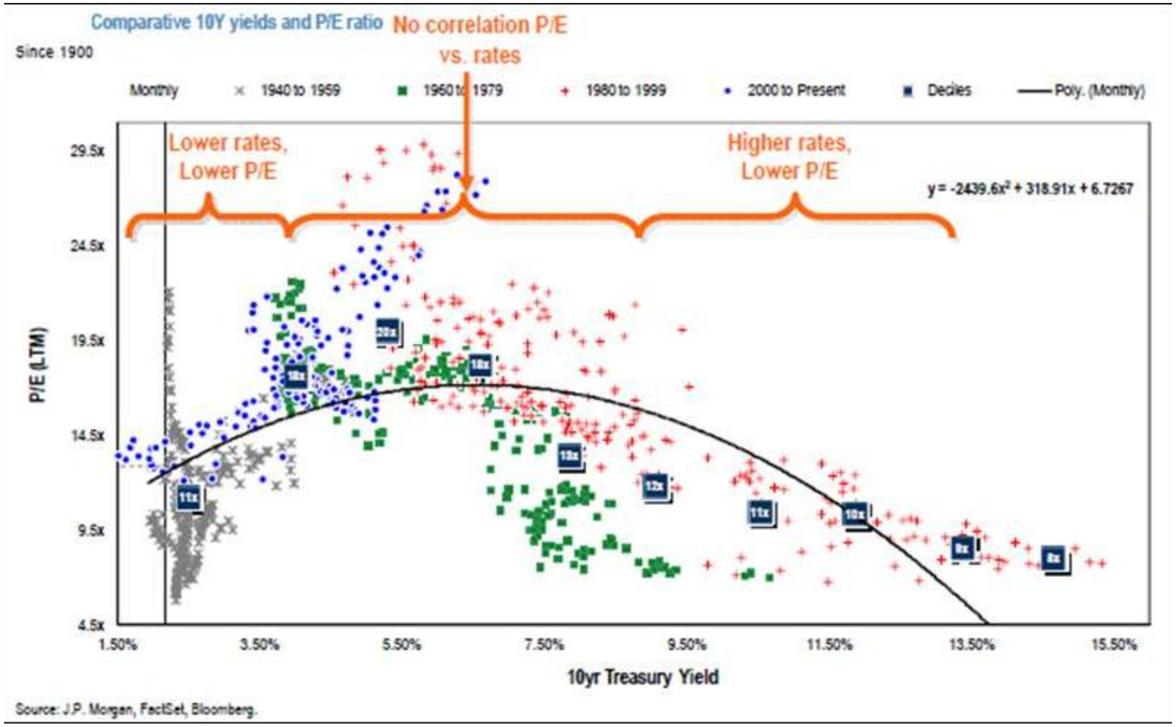
MSCI US	Implied growth rate		Earnings	Multiple	Dividend
Current		2013	103	17.3	2.03%
IBES Consensus	10.1%	2014e	114	16.3	2.03%
Bull case	13.3%	2014e	117	17	2.03%
Bear case	4.3%	2014e	108	15	2.03%

- Our scenario: Consensus earnings growth with small drop in multiple due to (limited) FED action
- But still positive returns because multiples are sustainable





Managers message: Rising rates and Equity returns

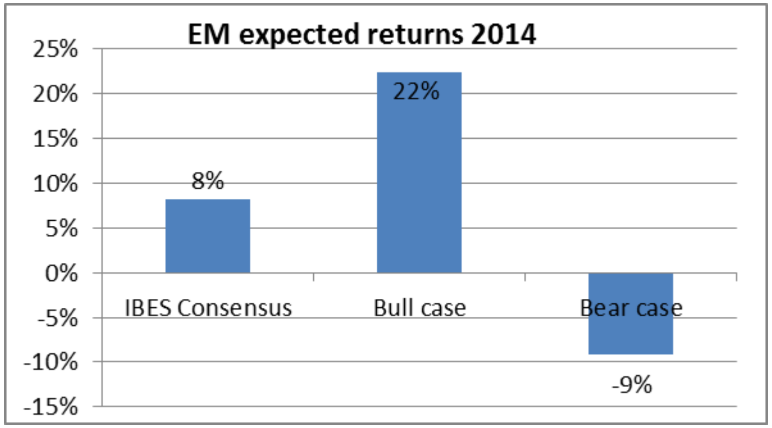


- Rising rates (or tightening financial conditions) can temper returns in US equities short term (hence our cautious stance for 2014)
- But long-term higher rates (from this low level) will not de-rate US equities (growth confirmation)

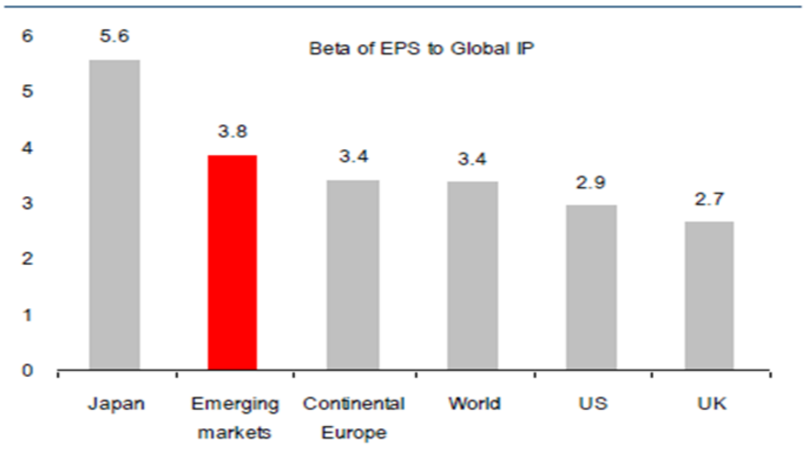
Expected returns 2014 – Emerging Equities

MSCI Emerging Markets	Implied growth rate		Earnings	Multiple	Dividend
Current		2013	89	12.5	
IBES Consensus	11.6%	2014e	99	11.8	2.83%
Bull case	15.0%	2014e	102	13	2.83%
Bear case	0.0%	2014e	89	11	2.83%

- Our scenario: consensus earnings growth with stable multiples
- Single digit, local currency, returns with room for upside if EPS growth picks up
- Bear case significant probability if EM doesn't profit like it did in the past from global growth momentum
- Or if further currency depreciation (on the back of FED action)

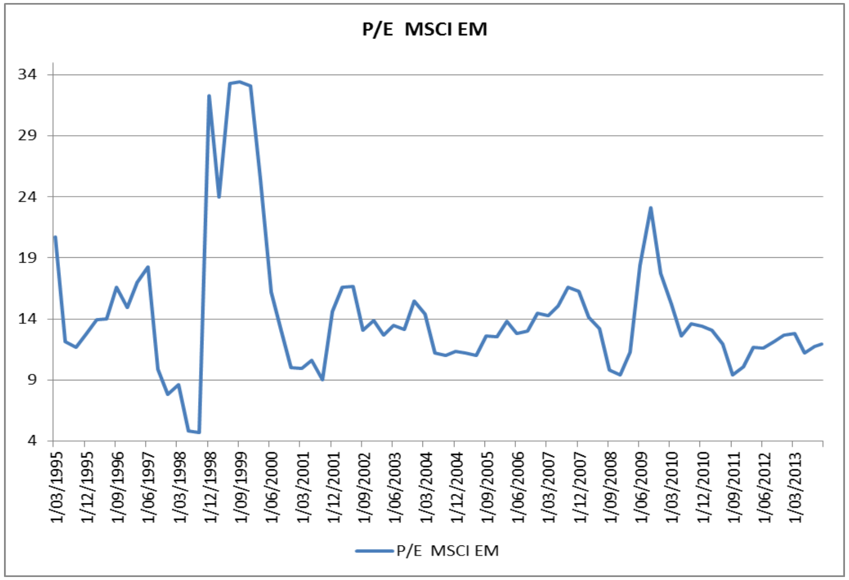


Petercam scenario Emerging Markets



Source: Thomson Reuters, Credit Suisse research

- Emerging market EPS very geared to Global IP momentum
- Our Macro assumption is a further pick up in IP momentum

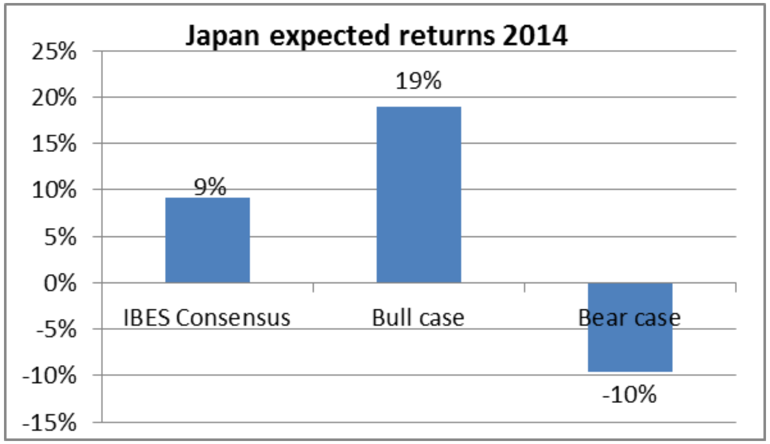


- Valuations at low levels
- No need for dramatic rerating to provide positive returns

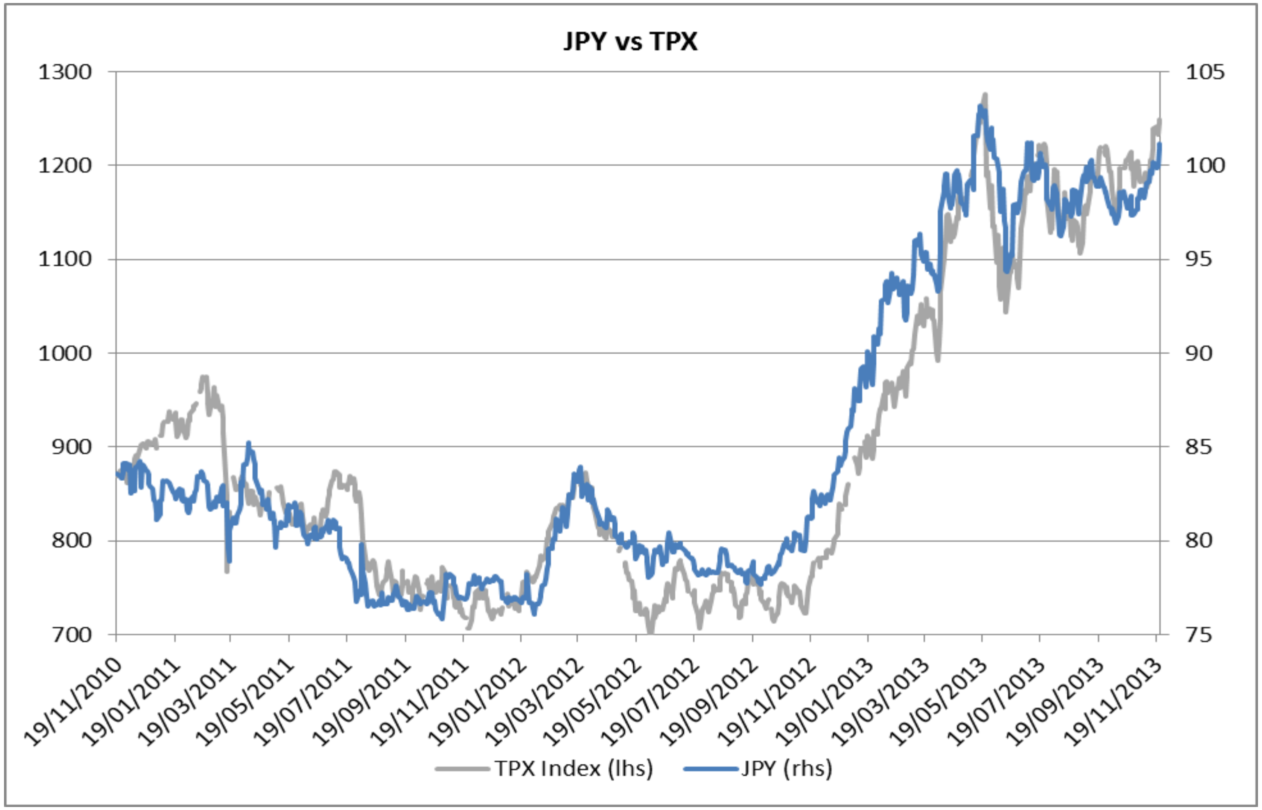
Expected returns 2014 – Japan Equities

MSCI Japan	Implied growth rate		Earnings	Multiple	Dividend
Current		2013	50	19.8	1.95%
IBES Consensus	8.8%	2014e	54	19.5	1.95%
Bull case	13.0%	2014e	56	20.5	1.95%
Bear case	3.0%	2014e	51	17	1.95%

- Our scenario: Bull case on the back of further weakening JPY and Japans gearing to economic momentum
- Room for more efficient use of balance sheets (buy backs, dividends etc.)
- Abenomics needs to succeed to prevent a very bad outcome for Japan
- Bear case would be the start of doubts in Abenomics: stronger JPY, weaker economic momentum and low earnings growth → multiple contraction



Petercam scenario Japan



- Japanese equities are very sensitive to the success of the macro & central bank policies

Agenda

- How did we do in 2013?
- Key theme 2014
- Expected returns 2014 FIXED INCOME
- Expected returns 2014 EQUITIES
- **Conclusions**

Conclusions

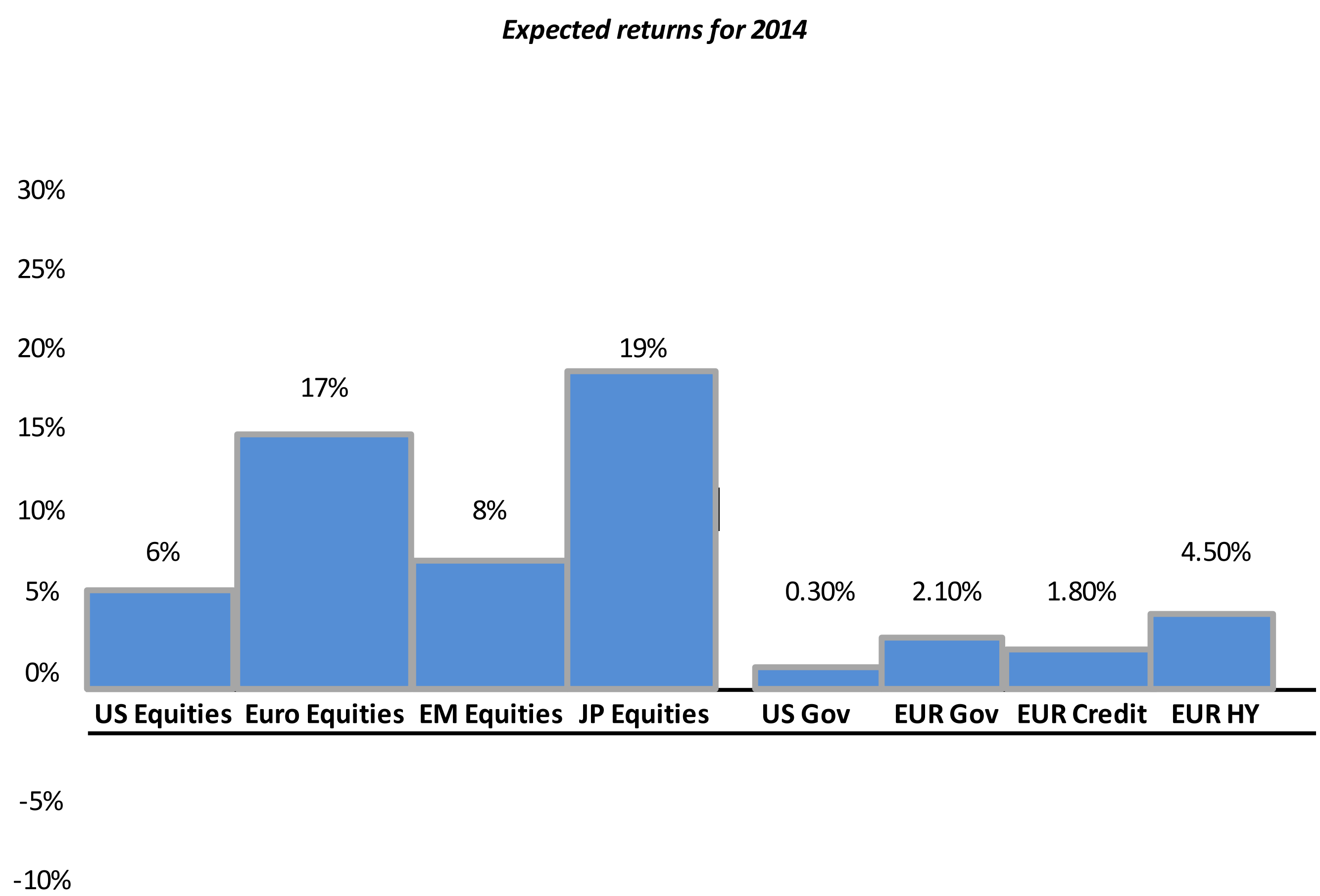
- Macro scenario looks good and the focus will be on the US Central bank (FED)

- Rates will rise and this will impact bonds
- But we expect that rise will be gradual and manageable
- Our fixed income strategies will be focused on finding pick up in the capital structure in IG credit and to add some default risk premium in High Yield.
- In both cases, the managers are actively managing the duration risks

- Equities should see good earnings growth
- But multiples have risen and leave therefore little room for expansion
- Rising rates will put downward pressure on multiples
- Our equities managers are looking for operationally geared companies that have strong cash flow generating capacities and will profit from any economic growth

- **2014 will be a year where potential changes in the monetary policy of the FED will drive asset prices**

Conclusions



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