For professional investors - **MAY 2014**

BNP PARIBAS
INVESTMENT PARTNERS
The asset manager for a changing world

PERSPECTIVES

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BNPP IP is the source for all data in this document as at end of April 2014, unless otherwise specified.

Hungry hunters

Should investors formulate a base case scenario and then...do the opposite? At least four developments this year have seen market reactions very different from what might have been expected. The euro has gained; events in Ukraine have barely had an impact; bonds have rallied and Japan has disappointed. What are the lessons? Consensus trades have inherent risks: the rationale may be so appealing that the trade is overcrowded and has little 'juice' left. To complicate matters, identifying a consensus trade is often easier said than done. If, however, investors can get into such a trade early on, it can pay off handsomely. Think of high-yield bonds in recent years. Another lesson is that if there is no catalyst to drive the market – as apparently in the case of Japan now – being positioned means incurring an opportunity cost. The third lesson is the need for exhaustive analysis. The euro has been expected to weaken the premise that bond yield differentials would turn against it. Differentials have risen but other, less obvious, factors took precedence. Fourthly, markets can be complacent – just look at their current stoicism even in the face of mounting geopolitical risk. Finally, central banks still dominate markets. Janet Yellen and Mario Draghi's comments have caused long US yields to flatten and 'peripheral' spreads in Europe to narrow impressively.

In summary, investors appear to behave like hungry hunters. They're impatient (positions need to pay off today rather than tomorrow), focused (on opportunities with a clear catalyst) and heed signals (from central banks). One could add they tend to hunt in packs (which explains the role of momentum).

7 May 2014

William De Vijlder
Vice-Chairman of BNPP IP

Joost van Leenders
Chief economist, Multi Asset Solutions team - BNPP IP, Amsterdam

Improved corporate earnings data should bolster equity markets

Equity markets have continued to progress over the last month making albeit modest gains. Developed equities extended their run of outperforming emerging equities. We believe that developed equity markets should increasingly derive support from improving economic growth in the US and Europe, low interest rates and the prospect of higher corporate earnings. We closed our overweight in US small caps and our duration underweight in short-dated bonds and went overweight in European inflation-linked bonds.

Economic data suggests a strong rebound is imminent in the US after a weak first quarter. What is your view on this and what will it mean for monetary policy?

Growth was indeed weak in the first quarter in the US, slowing to 0.1% QoQ annualised, as all components saw a negative performance except consumption. This rise in consumption may seem strange as consumers must have also suffered from the severe winter, but the spending surge was largely related to the introduction of the Affordable Care Act (Obamacare). More importantly, recent data showed that the US economy will likely rebound strongly in the second quarter. Consumption, production and durable goods orders were strong and more jobs were created in April than in any month since January 2012. The ISM manufacturing index has recovered and consumer confidence is trending higher. The first-quarter weakness did not keep the Fed from reducing its asset purchases. We expect the pace of tapering to be maintained for the rest of the year, with quantitative easing finishing before the end of 2014.

The most-watched indicator in the eurozone was probably inflation. It did rebound in April as expected, but it remains to be seen if it has now bottomed-out. Unemployment is still high and the output gap remains large. Leading indicators eased, but still point to stronger growth. Consumer confidence and car sales are up. Most of the downward adjustment in wages in the 'peripheral' EU-member states may be over. The latest ECB press conference strongly signalled some action at the June meeting, such as a small rate cut, but we think quantitative easing is less likely. A more creative solution to support bank lending to smaller companies cannot be ruled out with lending to the private sector continuing to contract in March.

> "More jobs were created in April than in any month since January 2012"

Have you seen any improvements in Japan or emerging markets?

Japan faces a weak second quarter. Consumption surged ahead of April's consumption tax hike and the payback is likely to drag GDP growth into negative territory, although only temporarily since unemployment has continued to fall and capacity and labour shortages are emerging. The Bank of Japan has not hinted at policy changes, so expectations for more quantitative easing as soon as July seem premature. On average, emerging market PMIs fell below 50, which signals no sign of improvement. But stronger exports in Korea, Taiwan and China offer some glimmers of hope.

You are still overweight equities. What are the main positive factors for this asset class?

Our overweight in equities is not just based on more growth and a stimulative monetary policy, but also on strengthening earnings given that valuations are stretched globally (particularly in the US). So far, higher earnings are more an expectation than a reality. Recent US earnings data exceeded market estimates, but expectations were low. US growth should be supportive, but margins are already high and labour costs could rise. In Europe, many companies have struggled to beat expectations, but earnings growth should improve since margins are generally low and should get a boost from sales growth.

Written on 9 May 2014

Alain Jaques
Product strategy manager, retirement specialist, BNPP IP, Paris

Novel solutions as pension provision shifts to DIY[1]

Collective pension provision is gradually being unwound as financing retirement is shifting from companies and governments to individuals. A new generation of target-date funds offers an innovative approach to investing over various investment horizons and meeting long-term investment needs.

Pension systems in developed countries are going through profound changes, with the burden of provision shifting from the state and the employer to the employee himself. Increasingly, budget austerity means the replacement rate[2] covered by so-called first pillar state systems is being cut and the shortfall is expected to be made up by second pillar occupational schemes and third pillar personal pension savings.

This trend means investment risk is being transferred to the employee, so increasingly in occupational schemes and of course in the case of personal pension provisions, it is borne entirely by the employee. Employee investment risk awareness and risk tolerance have been become essential issues for retirement plan managers to get to grips with.

A further challenge is the current investment climate in which low interest rates are making it harder for an investor with a medium to long-term investment horizon to protect and grow his capital. Investors therefore need all the help they can get to adapt this new paradigm.

The moving pension scene

The shift in risk sharing towards the employee/investor is highlighted by the trend of employers switching from defined benefit (DB) schemes with their pre-determined fixed replacement rates to defined contribution (DC) schemes where contributors have a greater say in the way their contributions are invested.

Offering cutting-edge solutions

Such challenges also impact pension funds which now have to tackle a new set of asset/liability related issues requiring adjustment of their retirement scheme offerings and investment management styles.

The changes create opportunities for asset managers to service pension funds' needs in fiduciary management, liability-driven investing (LDI) and risk overlay management. As for DC, target-date funds have been popular for some time, especially in the US where assets have increased by 800% over eight years totalling USD 550 billion.

The current market of target-date funds is mainly composed of fund ranges with no capital protection, thus not suitable for all investors, and – to a lesser extent – fund ranges that do offer a guarantee, therefore lacking room for capital growth in a low interest-rate environment. However, a new generation of target-date fund is emerging, offering two types of solutions:

Tailor-made: in line with the pension fund's specifications, such solutions combine liability-hedging portfolios (LHPs) in the form of zero-coupon type bonds to protect capital and performance-seeking portfolios (PSPs) using a range of mutual funds. The composition of the LHP/PSP mix typically shifts along a glide-path which can be time-dependent – the closer an investor is to his retirement date, the higher will be the share invested in the LHP – or path-dependent – the allocation to the LHP/PSP mix is adjusted over time in order to meet investment goals.

Packaged: using target-date funds that match a variety of investment horizons and individual long-term savings needs. Each fund can benefit from a guaranteed minimum net asset value at maturity, which can only go up over the life of the funds. How does this work? Every day, a current protection ratio is calculated using a formula linked to interest-rate levels and the time remaining until maturity. Multiplying this ratio by the NAV of the day gives you the protected value upon maturity. If this value is higher than the previous (business) day, it will be adopted; otherwise, the previous one is kept. Cases where the protected value at maturity is likely to go up include increases in interest rates and a decrease in the daily NAV or when interest rates are stable, but the daily NAV rises. As for new additional investments, the new protection ratio will rise when interest rates increase; in a higher interest-rate environment, this can lead to a protection ratio well over 100% of the capital for long-maturity funds.

We believe such innovative solutions can help place investors ahead of the curve in the current transformation of the pension landscape.

1 DIY is an abbreviation for do-it-yourself. DIY investing is an investment strategy where individual investors choose to build and manage their own investment portfolios.
2 The percentage of pre-retirement income paid out upon retirement.

Christian Dargnat
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Asset management faced with the onslaught of the web giants

Facebook is launching its own range of financial services[1]. Who knows how much longer we asset managers can hold out? Faced with the threat of extinction, we can only murmur "not yet". Ultimately, it's up to us to fend off the onslaught of the new economy on our business model.

Facebook's plans include an online payment system, following the example of PayPal as well as Bitcoin, the virtual currency with a volatility higher than that of the Russian rouble at the height of the Ukrainian crisis. Why is there such interest in this currency? When a Parisian taxi uses a device to process a passenger's payment, 4% of the amount goes to the intermediary bank, before adding on the fixed costs for the technology itself (renting the device, connection fees, subscription charges etc.). All this for a purely domestic transaction in a G7 country.

Just imagine then the transaction fees involved in a bank transfer between accounts on opposite sides of the world! Bitcoins involve extremely low transaction fees (only a few cents per million of euros exchanged) as well as a simplistic algorithm: the sharing of data between users. In other words, the higher the number of users, the more complex the system of protection becomes. As Facebook claims to have more than one billion users, imagine the level of security that its network enables!

The emergence then of new technologies and their exponential growth arises from two structural factors: the drive against the banking oligopoly where indirect fees are no longer accepted and global digitalisation, more specifically the capacity to constantly monitor user preferences. Facebook, Google and Apple are sinking under the weight of their cash reserves, but most importantly, they pride themselves on their outstanding technological advantages and their unrivalled data networks.

Does such an environment bring into question the future of asset management as we know it? Alibaba, China's leading distribution platform, started distributing money market products last year and has raised USD 65 billion in monetary funds in less than 12 months. Interest rates that defy all competition and a one-click deposit facility have wiped the floor with the outdated processes offered by conventional asset managers. The regulatory environment imposed in Europe and in the US by MiFID and Dodd Frank mean that it would be impossible to recreate the simplicity offered by Alibaba.

"The distribution model of asset management is under greater strain than ever and is undergoing deep structural change"

The simplicity no, but the level of potential demand yes! A significant share of current investors has grown up with the internet and naturally, this will continue to rise towards 100%! The distribution model of asset management is under greater strain than ever and is undergoing deep structural change. The ban on retrocessions is not the major change of the 21st century. More attention should be paid to the emergence of a new distribution channel, a network of enormous spider webs: the internet!

The great rotation for asset managers will after all be the switch from a distribution-centric to a manufacturer-centric model. The end of retrocessions, the setting-up of open architecture, the digitalisation of clients and the institutionalisation of their needs means the stage is now set for portfolio managers to return to the limelight.

Nevertheless, portfolio managers will have to show themselves to be innovative, audacious and capable of creating value. Without these qualities, low-cost beta exposure solutions will continue to thrive with distribution via 'Facebook Asset Management'. This is then a final wake-up call, a call to rally to the new technologies: we asset managers must innovate to offer portfolio management services based on listening and responding to the new needs of our clients. Otherwise, we will disappear.

1 See, for example Financial Times, 20 April 2014 "Fund managers fret as Facebook pushes into financial services".

Chi Lo
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A growth slowdown: Made in China

That China's growth momentum has slowed more sharply than expected in recent months highlights one of the short-term risks of structural reform. Beijing has a broad arsenal of policy measures for boosting growth should it want to, but for now the leadership is allowing the pendulum to swing towards reform success rather than growth.

As Beijing needs to manage the interests of the winners and losers on the road to the liberalisation of financial markets, there has yet to be any 'big bang' reform success. It has been paving the way for 'economic surgery' since 2013 by tolerating slower growth and pursuing tighter monetary and fiscal policies. This is reducing excess liquidity and forcing the economy to deleverage. It has cut excessive investment and government spending, and put a squeeze on corruption. Beijing's small steps to liberalise interest rates and expand onshore capital market investment quota for foreigners have started to introduce more market discipline into the domestic system.

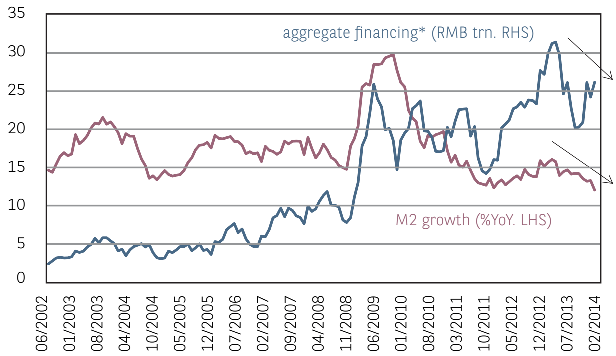
Nevertheless, this year's sharp slowing in growth suggests that Beijing might have underestimated the economic pains of structural change. To strike more of a balance between reform and growth, it has come up with a 'mini' economic stimulus package, using tax, lending and spending policies to boost targeted sectors, including SMEs, social housing, energy, urban infrastructure and central and western regional infrastructure.

It has implemented a credit-easing policy that cuts bank reserve requirement ratios (RRR), but only for qualified rural banks – a selective move to boost credit, and thus growth, in rural areas. It is unclear to us how effective this will be. The rural banks' average excess RRR is already more than 7% (it is 2.3% for all other banks), so a lower RRR may not necessarily prompt the rural banks to lend more.

If the impact on growth is uncertain, why does Beijing still want to implement this mini package? The likely answer, in my view, is its desire to send a subtle signal about its resolve to succeed in its planned reforms.

China's economy is suffering from 'growth fatigue'. Beijing knows that while another wholesale bailout package would boost growth, it would be less effective due to the misallocations of capital (see property markets) that have been building up in the economy. Reverting to the old bailout model would undermine the leadership's reform resolve and hurt its policy credibility. The mini stimulus package is aimed at boosting selective sectors that genuinely need investment, without spurring investment excessively.

Exhibit 1: China's tight monetary bias



sources: CEIC, BNPP IP (Asia)
* net flows of total social financing, 6mm

The sharper-than-expected slowdown in growth on the back of falling liquidity (Exhibit 1) is not, as many assumed, simply a result of China's economic woes; it is also proof of Beijing's reform resolve – at the expense of growth – to fix these economic woes. If the stimulus package proves insufficient to halt the growth slowdown, Beijing is expected to enlarge it, perhaps to include interest rate and broader RRR cuts.

Current liquidity appears tight relative to profit conditions. The weighted average for the one-year lending rate is about 7.4%, but the average corporate profit margin is about 5%. Furthermore, broad money supply (M2) growth and net aggregate financing have fallen sharply due to a (perhaps overly) cautious monetary policy stance. Further deleveraging will also keep credit conditions tight.

If the pace of growth remains sluggish in the second quarter, further policy easing looks likely. While the odds of an economic hard landing currently look very low, such further easing might be just the recipe for a rebound in Chinese asset prices that the financial markets seek. If growth momentum picks up and inflation remains subdued, China's outlook should improve. In short, China is not in crisis. The slowdown is more a sign of Beijing trying to fix economic woes than a result of them. The economy has been slowed down by choice, and for good reasons.

Expert's view
SPOTLIGHT

Raul Leote de Carvalho
Head of quantitative strategies and research, Financial Engineering, BNPP IP, Paris

Gaining more by losing less in global bonds

Contrary to conventional wisdom, less volatile stocks tend to beat the broader market over the long term, a phenomenon long recognised in equity markets. Research by our Financial Engineering team suggests that such a 'low-volatility' anomaly can create attractive opportunities for bond investors as well.

In recent years, the search by investors for more stable returns has rekindled interest in a powerful, but oft-ignored market anomaly – the fact that less volatile stocks tend to outperform broad market indices over the long term.

Less volatile stocks tend to escape the ill effects of boom and bust cycles. While they do not soar when markets rally, but do gain, they do not suffer the full brunt of market crashes. Instead, their capacity to generate relatively regular incremental returns means they typically compound more of their gains over the full market cycle.

Despite Albert Einstein's reference to compound interest as the eighth wonder of the world, such compound returns remain an often-underestimated engine of investment results. In part, this is due to the foibles of human nature which continually lead many investors to overpay for riskier stocks for what is effectively the small chance of winning big. Overconfidence in their own ability repeatedly leads them to jump on bandwagons at precisely the worst time.

The search for investment strategies to harvest the low-volatility anomaly has in recent years led to the development of a number of quantitative strategies using statistical methods to analyse market prices and devise models that take the risk characteristics of a stock into account. Research has shown that this type of systematic, 'risk-based' approach to investing can improve the trade-off between return and risk by exploiting specific risk characteristics of a financial asset.

Risk-based strategies such as minimum variance, maximum diversification and risk parity are used in equity funds to gain exposure to the alpha in low-risk equities. Our Financial Engineering team has found that these strategies are, however, of no use to capture the alpha of low-risk fixed income.

- The minimum variance portfolio would invest in just a few bonds with short maturities. It would incur prohibitively high rebalancing costs and feature a high tracking error and extremely low levels of risk and return compared with the market capitalisation index.
- Maximum diversification would suffer from much the same problems since, like minimum variance, it would be heavily tilted towards the lowest-beta bonds. The same problems of prohibitively high turnover, low risk and returns, and concentration in short maturities should be expected.
- Finally, a risk-parity strategy would result in unmanageable fixed-income portfolios invested in all the bonds in the universe.

Lower-risk bonds can generate positive alpha

In an extensive study[1] of bond markets, the Financial Engineering team found that the low-risk anomaly first identified in academic research in the early 1970s was observed universally in global fixed-income markets between January 1997 and December 2012. The empirical study showed that lower-risk bonds generated positive alpha irrespective of the currency or market segment under consideration. The results are extremely consistent and comparable for sovereign bonds, quasi-government and foreign government bonds, securitised and collateralised bonds, corporate investment-grade bonds, corporate high-yield bonds and emerging market corporate bonds. Aggregates of some of these market segments generated equally consistent results, thus supporting the universality of the anomaly.

What does this mean for investors?

In our view, the results of this study have significant implications. From a risk-return point of view, investing in lower-risk fixed income can result in a higher Sharpe ratio. Including lower-risk fixed income in a strategic asset allocation portfolio should thus improve the overall risk-adjusted return. It is true that lower-risk bonds also generate lower returns despite the positive alpha. However, there is a trade-off to be made by investors in terms of improvement in the Sharpe ratio and just blindly seeking higher returns with the higher risk associated with a large exposure to the market risk premium and potentially negative alpha.

This is even more the case now as we would expect investing in fixed-income market capitalisation indices to generate much lower returns over the coming years than those seen during

1 See the white paper, "Low-Risk Anomalies in Global Fixed Income: Evidence from major broad markets", forthcoming in the next issue of the Journal of Fixed Income, vol. 23, no. 2 (2014).

> "Our empirical results show that lower-risk bonds generated positive alpha irrespective of the currency or market segment"

the back-testing (1997 to 2012), which was one of the most favourable periods in the history of the bond market. The emergence of the fixed income asset class from a long and strong bull market means that now is probably the best time in many years to profit from the low-risk anomaly from an absolute point of view. This assertion is based on the view that after such a long period of positive returns, investors may have grown complacent about the risks in fixed income when rates eventually rise.

As bond markets stabilise after their strong bull run, it is not unrealistic, in our view, to expect that the long-term Sharpe ratio of the fixed income asset class will return to lower levels in the next few years than those seen between 1997 and 2012. Lower returns of high-beta fixed income, perhaps even negative returns, can make investing in low-risk fixed income with positive alpha and low beta even more appealing. Small amounts of leverage, if built with low leveraging costs, should allow investors to boost returns. Investing in low-risk corporate investment-grade and high-yield bonds could be of particular interest to investors seeking higher returns and lower exposure to the market risk premium since it would bring additional return from the credit exposure.

How best to capture the low-risk anomaly in fixed income

From a relative perspective, our results suggest that benchmarked investors should build their tracking error risk by investing in portfolios with a beta just below 1, but not too low, and a lower volatility than the market capitalisation index. Such defensive portfolios should outperform the market cap index substantially when that index does poorly. When the market does well, it should generate broadly similar levels of return to the market, since the alpha from the lower-risk bonds should compensate for the drag created by a beta of less than 1. These portfolios should have a higher Sharpe ratio than the market cap index, a positive information ratio over the medium to long term and an asymmetric profile of average excess returns – relatively large and positive when the index returns are negative and close to zero when the index returns are positive.

Non-benchmarked investors have more leeway since they are less concerned about tracking error. They will prefer absolute performance over consistent outperformance of the index. This can be achieved by investing in a well-diversified core portfolio of lower-risk bonds from different segments of the global fixed-income universe, which, as our research has demonstrated, should deliver a higher Sharpe ratio thanks to the positive alpha. They can then seek additional performance by also investing in satellite portfolios that exploit other anomalies such as value or momentum.

Responsible Investment
SPOTLIGHT

Alexandre Jeanblanc
SRI investment specialist, BNPP IP, Paris

The environment: investment's new Holy Grail

The release of the latest report of the United Nation's Intergovernmental Panel on Climate Change (IPCC)[1] on March 31 was the first update in seven years. The report is seen as the definitive account of scientific evaluation of the effects of climate change, highlighting the sweeping consequences it will have on our lives and livelihood. Alexandre Jeanblanc, sustainable and responsible investment (SRI) investment specialist, outlines the constraints governing environmental investment funds: contributing to the resolution of environmental issues and enabling a greater number of the world's citizens to improve their standard of living.

Perspectives (P): *Is there potential for environmental issues to profoundly modify the economic and social equilibria that we today take for granted?*

Alexandre Jeanblanc (AJ): The question of the environment turns on two issues central to the future of humanity and the planet.

The first is that the world's population continues to grow. Moreover, people in emerging economies aspire to improve their standard of living. Forecasts suggest that, for example, in 2030, the average Chinese consumer will eat an estimated 75 kg of meat annually, up from just 54 kg in 2010[2]. Or, on a global scale, it is estimated that in 2030, we will have 1.7 billion cars globally[2], almost double the number we have today. Obviously, these two simultaneous phenomena – population growth and higher living standards in emerging economies – will boost demand for natural resources.

Increased demand is already showing up in higher commodity prices and has been doing so since the late 1990s. To address this situation, there are two complementary options. The first consists in continuing to exploit existing resources, for example by tapping into new oilfields and bringing new farmland under cultivation. The second, which to me is inevitable and necessary, consists of using renewable resources, but, above all, being more efficient and thriftier in the way we consume.

In parallel, and this is the second issue, the development of modern economies is threatening natural balances. The most obvious of these is the dramatic pollution in some Chinese cities. Another one is climate change, which is already causing alarming water shortages in some areas and tragic cyclones and flooding in others. For example, according to projections, in 2030 almost half of the world's population will live in water-scarce areas[3]. And 2030 is just around the corner! Also keep this in mind: the inability to come up with solutions to these environmental challenges will lead to major social unrest and geopolitical shifts that are still unpredictable.

So it is in terms of resource scarcity and sustainable development that the environment theme takes on its full meaning. And it is because these two factors are inevitable that we expect robust growth in the environmental (investment) sector over the next 20 years.

P: *What sort of companies currently operate in the environmental sector?*

AJ: In defining this investment universe, you might say that the environmental story can be broken up into three main aspects: I) energy, II) water and air, III) waste management and others.

In greater detail, we see that energy means energy efficiency. An example is Schneider Electric, which, among other things, makes variable-frequency drives that can reduce power consumption by 30% in ventilation systems. Energy of course also includes alternative energy sources. One illustration of this is the Danish company Vestas, which manufactures and installs complete wind-power systems.

Water means supply infrastructures and water-treatment systems for both before and after use. One new technology comes from US company Danaher, which makes water-treatment systems based not on chemical additives but on ultraviolet radiation or ozone technology. Water also means utilities such as Suez Environnement. When we talk about air we mainly mean pollution control. A good example is Umicore, the Belgian company that makes and recycles catalytic converters.

Waste management mainly involves the collection and recycling of waste. An example is Lee & Man Paper Manufacturing Ltd., a Chinese company that does business all over Southeast Asia, recycling paper and cardboard on a large scale.

Finally, other environmental activities include companies that do not fall under these categories such as Linde, Air Liquide's main competitor, which produces very pure gases for de-sulphurising crude oil or reducing pollution in steelmaking.

1 The IPCC is a group of more than 200 experts from around 40 countries. www.ipcc.ch.
2 McKinsey Global Institute, Resource Revolution report, Nov 2011, page 5.
3 Bank of America Merrill Lynch ESG & Sustainability report, "A Blue Revolution – global water", 7 Nov 2012.

"We believe that the performance of environmental funds should exceed those operating in other areas of the economy"

About 1400 companies worldwide can be said to have at least 20% of their business exposed to dealing with environmental issues, based on the categories I've just mentioned.

P: *What sort of potential does the environmental sector offer for growth? As a sector is it likely to offer outperformance?*

AJ: Regarding investment performance (net-of-fees in euro terms), from 2008 to 2013, environmental investment funds generally underperformed the rest of the market, mainly because the economic slump then caused both politicians and investors to put environmental issues on the back burner, particularly regarding renewable solar and wind energy. However, we feel that environmental problems cannot continue to be ignored. The planet's natural, economic and demographic equilibria are at stake, along with, more prosaically, governments' abilities to ensure the survival of industrial activities, to address citizens' concerns, and to prevent serious social unrest or even humanitarian disasters.

Some governments, under pressure from manufacturers in the environmental sector, have recognised that these are new sources of growth for the coming decades and are taking action. In Europe, the US and Asia, an increasing number of legislative and regulatory initiatives are being taken to clean up water and air pollution and to deal with climate change. Some recent examples: the EU's "Air Quality Package to 2030" or the "2030 Climate and Energy Framework", the Canadian ban on building new coal-fired power plants, California's decision to promote zero-emission cars or Chinese government measures to reduce air pollution and increase the number of water-treatment plants.

To conclude, could certain environmental funds' outperformance versus the MSCI World index in 2013 be harbingers of the spurt that we expect?

P: *As investors, how can we be sure that environmental funds fulfil their declared objective of investing on an environmentally-responsible basis?*

AJ: Some environmental funds have received LuxFLAG and Novethic Green Fund labels, which are awarded to funds that invest, in a responsible manner, in sectors linked to the environment. To obtain these labels, environmental funds are prohibited from investing in companies not complying with the main principles of the UN fundamental declarations, namely the Universal Declaration of Human Rights, the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and finally the United Nations Convention Against Corruption. Our Environmental, Social and Governance (non-financial criteria known as ESG) principles are based on these UN declarations. Thus, firms involved in environmental scandals or in corruption cases, or those firms that do not respect the minimum rules of governance – for example, in terms of the alignment of interests between shareholders and the management team – can be excluded.

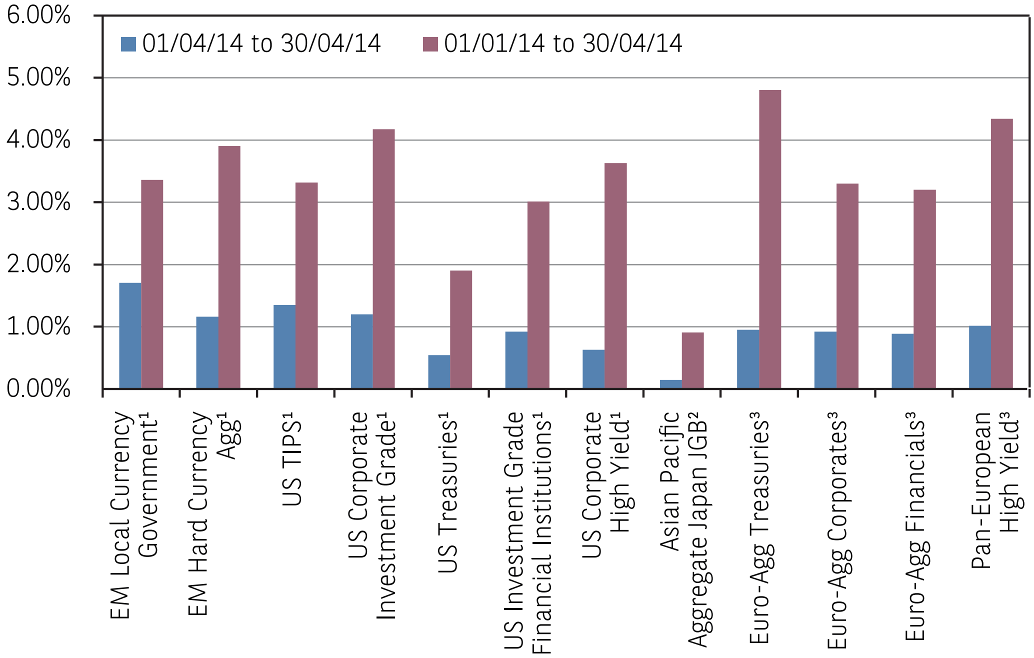
In summary, environmental funds provide a response to environmental challenges. They enable investors to direct investments towards those firms that are discovering, inventing and putting into place environmentally-friendly solutions. Environmental issues are long-term issues; in our view substantial investments will be made in the sector. As a result, the rate of growth of businesses in this sector should be greater than for the rest of the economy. The sector will also benefit from the existing regulatory framework that governments will continue to develop. For all of these reasons, we believe that the performance of environmental funds should exceed those operating in other areas of the economy.

Performance focus

SPOTLIGHT

Performance of selected equity markets for the period from 1 January to 30 April 2014

Performance of different fixed income segments YTD and from 1 April to 30 April 2014



1 in USD terms
2 in JPY terms
3 in EUR terms

Source: Barclays Capital, as of 6 May 2014

Performance of selected equity markets YTD

	Absolute return, in euro currency terms year-to-date through April 2014	Absolute return, in US dollar terms or, where indicated, in local currrency terms, year-to-date through April 2014
S&P 500	1.36%	1.93%
Nasdaq	-2.03%	-1.49%
EURO STOXX 50	2.88%	3.45%
Shanghai SE Comp	-7.92%	-4.24% (in Chinese yuan renminbi terms)
Brazil IBOVESPA	5.23%	0.23% (in Brazilian real terms)
Japan TOPIX	-8.61%	-10.74% (in Japanese yen terms)
South Korean KOSPI	-0.89%	-2.46% (in South Korean won terms)
Indonesia - Jakarta Comp	19.17%	13.24% (in Indonesian rupiah terms)
Russia MICEX	-20.04%	-13.17% (in Russian ruble terms)
Turkey BIST 100 Index	10.04%	8.95% (in Turkish lira terms)
India S&P BSE 500 IDX	8.30%	6.42% (in Indian rupee terms)

Source: Bloomberg, as at 30/04/2014. All indices price change only (excluding dividends)

Performance of selected equity/bond markets is shown in local currency terms in order to provide an indication of whether these currencies have appreciated or depreciated versus the euro and/or the US dollar during the period concerned.

Past performance is not indicative of current or future performance.

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