ROBECO

Monthly Outlook
Tectonic shifts in the world economy

In this issue

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Highlights

- The Fed has made it very clear that it is unhappy with its current policy of 'uber' stimulus, despite the benign inflationary environment and lackluster developments in the labor market. The Japanese economy will show a strong second quarter. The euro-zone economy shows new signs of stabilization, but political tensions in Greece and Portugal are on the rise. In general, economic news from the BRIC countries has been disappointing.

- The removal of excess liquidity through Fed tapering is less imminent than the market expects. We do expect this to happen, but not until fourth quarter 2013. We maintain our positive view on risky assets and are particularly positive on HY corporate debt, as the recent sell-off seems overdone and absolute yields remain attractive. We also like equities.

- We remain positive on real estate. Dividends are still attractive and as we expect the recent interest rate rise to moderate, the high degree of interest rate sensitivity becomes less of a dominant factor. However, less attractive valuations could increase short term volatility.

- After tempering our optimism in recent months, we are now neutral on emerging market debt as we expect more currency volatility in EM due to heightened political tensions in the region. The risk-off sentiment resulting from a stronger dollar also puts pressure on EM FX. Performance will improve if sentiment turns, but the underlying deterioration in economic fundamentals and restricted room for countercyclical policy action demand a more cautious stance.

- The outperformance of defensives last month is indicative of the market's lack of conviction in the Fed's promises of growth. We think this outperformance is set to continue as macro data and earnings revisions favor defensive sectors over cyclical sectors. Also, sentiment is still in a more risk-off mode. Surprisingly strong economic data is a tail risk to our view.

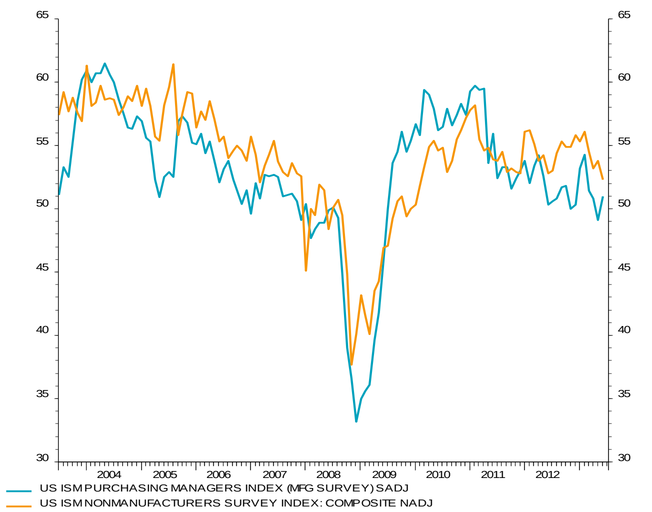
Macroeconomic view

Global economy

In June long yields on ten year US Treasuries rose further briefly ticking up to 2.6%, after the Fed president made it very clear that his enthusiasm for monetary 'uber' stimulus is waning, despite the benign inflationary environment and lackluster developments in the labor market. In Japan volatility in the bond market has risen, but ten year yields are still hovering below 0.9%. The yen has resumed its slide against the USD, breaking the 100-level at the end of June. The economy is showing signs of improvement. The euro-zone economy is showing new signs of stabilization, but political tensions in Greece and Portugal are on the rise, gradually pushing up peripheral bond yields. In China the authorities have allowed the interbank interest rate to skyrocket, probably to get a better grip on the shadow banking system and to discourage speculation. The Chinese economy will struggle to achieve its 7.5% growth target. In general, economic news from the BRIC countries has been disappointing. Due to increasing political instability in the Middle East, the oil price is moving higher.

North America

US: manufacturing and non-manufacturing ISM indices



Source: Thomson Reuters Datastream

At its last meeting, the FOMC authorized its president, Ben Bernanke, to present an unusually detailed target time schedule for scaling back its bond purchases later this year, from the current level of USD 85 billion a month. The schedule has the program ending by the middle of 2014, when the unemployment rate has hit a low of 7.0% and thus, en passant, introduces yet another reference rate. Clearly, the Fed is uncomfortable with its current policy of 'uber' stimulus. At the same time, its preferred inflation indicator, the PCE price index is low: the core figure was an annualized 1.1% in May and the headline figure 1.0%. It is therefore quite understandable that one member, James Bullard, dissented. He would prefer the Fed to more strongly signal its willingness to defend its inflation goal of 2.0%. The gradual improvement in the US unemployment rate from a high of 10% in October 2009 to 7.6% in May this year is less impressive than it initially appears as a consequence of the 'discouraged worker' effect. Bernanke stressed that future policy will remain data dependent. But of course, the tightening consequences of his remarks were felt worldwide.

A key question for us is whether the US economy is in a strong enough position to take the announced monetary tightening, especially in the light of the fragile global environment. A warning sign was the unusually large, third downward revision of US 2013 first quarter GDP from 2.4% to a meager 1.8%, caused by disappointing consumer expenditure, which of course can be partly attributed to the hike in wage taxes. Recent news on the housing market was positive, but market attention will focus on the effects of the recent spike in mortgage yields. Fortunately, the dip in the ISM manufacturing index in May below 50 turned out to be a temporary blip: in June it rebounded to 50.9, signaling expansion. The new orders component was promising (rising from 48.8 to 51.9), although the employment component was disappointing (declining from 50.1 to 48.7). Across the board spending cuts (also known as sequestration) will continue relentlessly, as a 'grand bargain' in the US Congress is becoming less and less likely. President Obama has instigated the de facto dismissal of Ben Bernanke, whose term ends January 2014, by declaring that he has been at the Fed 'longer than he wanted'. The most likely replacement is current FOMC member and fellow Bernankian, Janet Yellen, odds-on favorite as far as Senate confirmation is concerned. We do not expect the US economy to accelerate in the third quarter, but to continue to growth at a modest pace. Inflation will probably decline further. Tapering will probably start in the fourth quarter 2013.

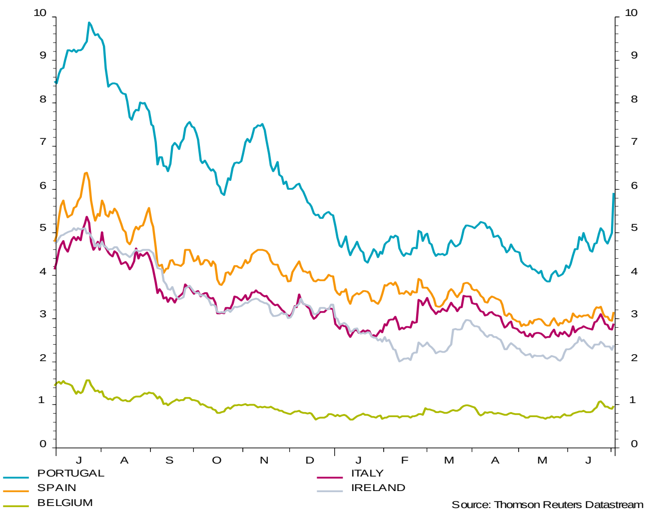
Rising political instability in the Middle East (Egypt, Syria, and Turkey) has recently been pushing up the oil price again, but we consider a hiccup in the oil supply unlikely. Tensions with Iran have eased, as the surprise election of a moderate paves the way for another round of negotiations. Iran has once again won more time.

Europe

The PMI index for the UK service sector jumped further in June from 54.9 to 56.9, signaling an impressive acceleration in the British economy. All eyes are on the new Canadian governor of the Bank of England, 'wonder boy' Mark Carney, who took over on July 1, but in the light of the convincing strengthening of the UK economy more QE is highly unlikely. We also doubt whether we will see more forward guidance on the future of QE or interest rates in the short term.

Somewhat surprisingly, on the eve of crucial German elections on September 22, political tensions in Southern Europe are on the rise again. Apparently, the weakened Greek government is running into difficulties with the troika, which is seeking guarantees that the Greek government will continue to lay off public sector workers. In Portugal the Prime Minister is struggling to avoid early elections. Austerity policies are reaching their political limits. European policymakers will most likely do their utmost to keep tensions in check at least until September 22. The ECB cannot step in with OMT for either of these countries, as they have not demonstrated full bond market access.

Ten-year yield spreads versus Germany (%)



Meanwhile the euro zone economy is showing tentative signs of stabilization, with the euro zone Composite PMI strengthening to 48.7 from 47.7, but still indicating shrinkage. German manufacturing is losing momentum.

The European leaders reached a compromise on one aspect of the banking union, which foresees a larger role for creditor bail-ins before any tax payer support can be given. The ESM can be used to a limited extent to recapitalize banks directly. As any compromise has to be ratified by the European Parliament it is unclear whether it will be possible for the ECB to take on the role of central banking supervisor in the second half of next year. A delay to nearer the end of next year is possible.

As a consequence of the tentative signs of economic stabilization, the European Central Bank will be very reluctant to engage in additional easing measures. Market talk suggests a new LTRO (five years?) is a real possibility, but we are skeptical. With headline inflation increasing to 1.6% on a yearly basis, it is becoming less easy to reproach the ECB with the fact that it isn't doing enough to prevent deflation and the rising oil price will prevent a significant reduction in inflationary pressure. But core inflation, at an uncomfortably low level of 1.2% on a yearly basis could intensify pressure on the ECB in the months to come. In general, we do not expect the ECB to be too forthcoming in helping euro zone sovereigns out of trouble. The relative calm on European bond markets will therefore be fragile and could easily deteriorate.

Pacific

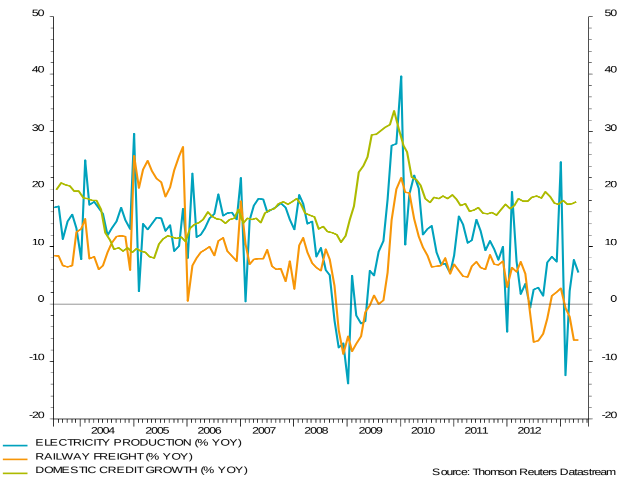
With a weakening China, a fading mining investment boom and consumers cutting back on spending, economic growth will weaken and the RBA will have some room to cut interest rates further.

In Japan, the tankan rose to 4 from -8 in the previous quarter, showing a clear improvement in business sentiment among major manufacturers. After an impressive first quarter, the second quarter will be strong as well. Tokyo consumer prices no longer declined in June on a yearly basis. So, Abenomics is doing relatively well and the yen is resuming its downtrend vis-à-vis the US dollar.

BRICs

Forward looking indicators points towards further slowing in the Chinese economy. The Chinese central bank has accepted a surge in the SHIBOR (Shanghai Interbank Offering Rate) in an apparent attempt to punish banks for their accumulation of risky leverage and mismatched maturities through the shadow banking system. This harsh reminder of moral hazard against the background of a further weakening economy shows that the Chinese authorities are pretty complacent about missing their 7.5% GDP growth target. Chinese inflation continues to behave itself, coming down to an annualized 2.1% in May.

Chinese economic indicators preferred by Li Keqiang



In a bid to try to slow inflation, Brazil's central bank has accelerated its interest-rate increases by hiking the Selic by 75 basis points since April against a backdrop of a weakening economy and rising social unrest. Growth will be subdued; the Brazilian central bank will probably have no choice other than to hike rates still further. In a U-turn Brazil has lifted its capital controls, but this has failed to restore confidence.

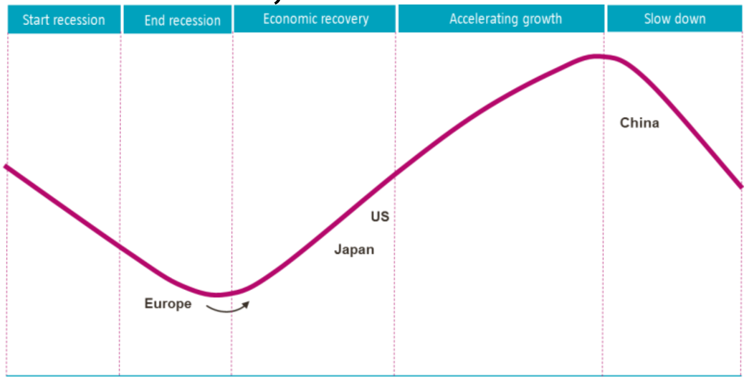
In Russia the economy slowed further in June. Inflation is accelerating thus limiting the options of the central bank, which kept its rate unchanged in June. Eventually it will cut rates, but probably only in the next quarter.

The Indian economy was hit by severe debt and equity capital outflows. The rupee has depreciated by about 10% vis-à-vis the US dollar. As a consequence, the improvement in inflation is likely to be only temporary. Producer confidence is waning despite a monsoon with above average rainfall so far.

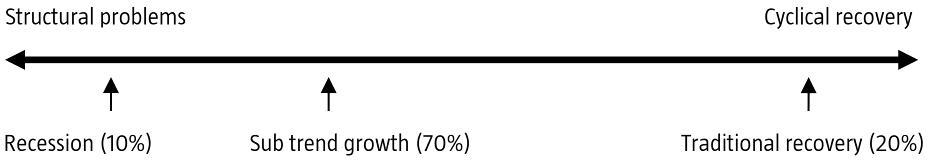
Position in the economic cycle, macroeconomic scenarios & Robeco's view versus consensus

Global economic growth will be lower than trend due to structural problems. Currently we see a weakening in global growth momentum. Our baseline scenario therefore remains one of below-trend growth, and we have raised the likelihood of this slightly, to 70%. The likelihood of a global recession has diminished to 10%. We maintain our forecast of 20% for the likelihood of a traditional recovery because of positive developments in the US economy, a stabilizing Europe and a modestly improving Japan.

Position in the economic cycle



Macroeconomic scenarios



Source: Robeco

Consensus estimates of economic growth and Robeco's expectations

GDP growth by region (%)	*2012*	*2013*	*2014*	*Δ-1m 2013*	*Robeco**
US	2.2	1.9	2.7	-0.1	=
Eurozone	-0.5	-0.5	0.9	-0.1	-
UK	0.3	0.8	1.6	0.1	=
Japan	2.0	1.4	1.5	0.1	=
China	7.8	7.9	7.9	-0.3	-
India	5.0	6.1	6.8	0.0	=
Brazil	0.9	3.1	3.7	0.0	-
Russia	3.4	3.2	3.8	-0.1	=
World	2.0	2.0	2.8	-0.1	=

* indicates whether we expect a higher (+). matching (=) or lower (-) growth rate than the current consensus estimate for 2013

Source: Consensus Economics. Robeco

Consensus estimates of inflation and Robeco's expectations

CPI by region (%)	*2012*	*2013*	*2014*	*Δ-1m 2013*	*Robeco**
US	2.1	1.6	2.0	-0.3	=
Eurozone	2.5	1.6	1.6	-0.1	-
UK	NA	3.3	3.0	-0.1	=
Japan	0.0	0.0	1.9	0.0	=
China	2.6	3.0	3.5	-0.2	-
India	10.3	8.2	7.4	0.0	-
Brazil	5.8	5.7	5.7	0.1	=
Russia	6.6	5.9	5.5	0.0	-
World	2.4	2.1	2.5	-0.1	-

* indicates whether we expect a higher (+). matching (=) or lower (-) inflation rate than the current consensus estimate for 2013

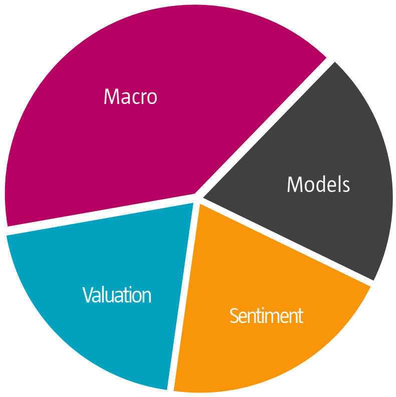
Source: Consensus Economics. Robeco

Financial markets outlook

Our expectations are based on qualitative and quantitative analyses. Our starting point is to look at the long-term macroeconomic environment. We then determine our expectations for the economy for the next three to six months to find out which developments could take the market by surprise, as this is a common factor for all asset classes. This macroeconomic analysis determines our initial preference in terms of assets.

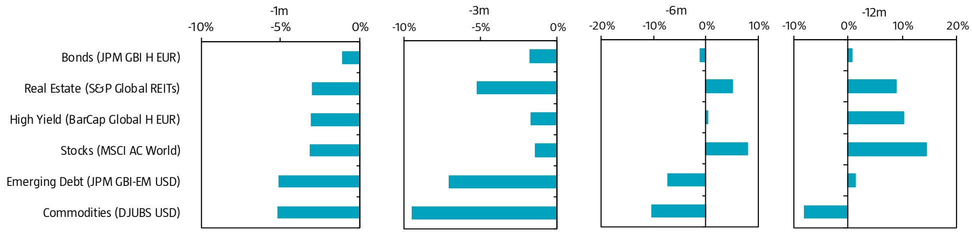
Next, we challenge our macro analysis with input from financial markets. Here, we take valuation into account as, at extreme levels, this might cause the performance of an asset class to change direction. Sentiment also plays a role, as markets tend to extrapolate shorter-term trends as investors put too much weight on recent developments. Finally, we use quantitative models to steer our expectations.

Input factors for our investment policy



Asset allocation

Performance of asset classes (gross total return)

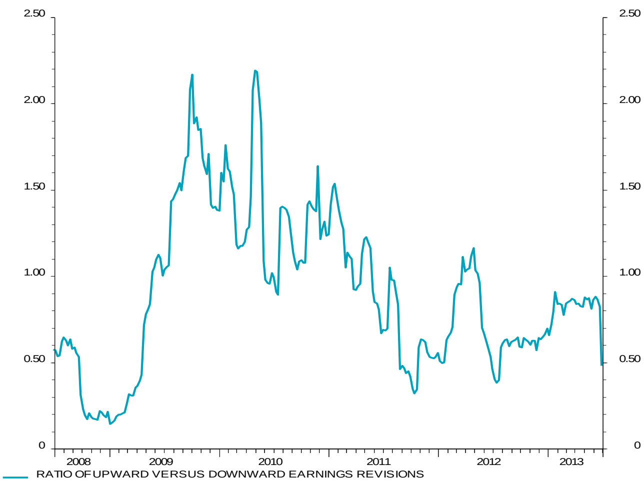


Source: Thomson Reuters Datastream. Bloomberg. Robeco

Equities

We maintain our positive view despite the recent anxiety in the market about earlier-than-expected Fed tapering. The market correction hit emerging markets and euro zone particularly hard, while the US remained stable. In our view, the market is still underestimating the conditionality of the Fed statement as Bernanke only intends to taper when economic growth is resilient enough to withstand a higher yield environment. Although the debate about Fed tapering could be indicative of a somewhat stronger US growth path, we think the Fed is too optimistic. We maintain our view that earnings margins have not much room left to expand further. In the event that US growth does surprise on the upside, earnings will mainly improve through higher sales. Earnings growth for now remains flattish, but is sustained through still healthy interest-rate coverage ratios, moderate wage growth and low depreciation costs as investment activity remains subdued. Given the recent deterioration in sentiment, investors should be all the more aware that returns in the summer tend to be low. Risks to our equity view have edged up somewhat with worsening geopolitics, especially in emerging markets. This will pose a risk to the cash flow of emerging market oriented European

Earnings revisions MSCI AC



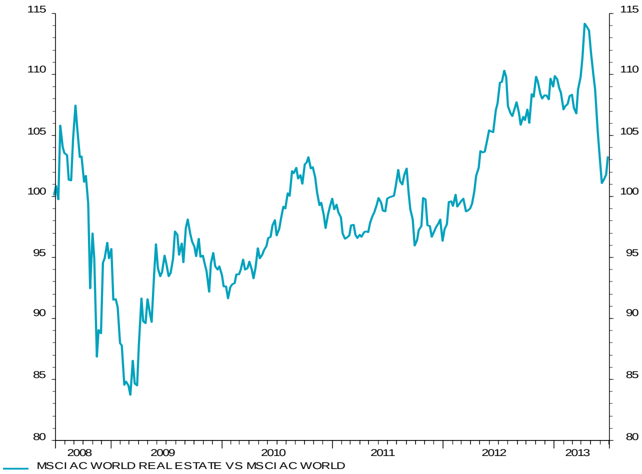
Source: Thomson Reuters Datastream

multinationals. Also, very positive macro news from the US could cause interest rates to overshoot again.

Real estate

We remain positive about real estate. This asset class only slightly underperformed equities last month. This indicates the market is not yet overly concerned about valuations in the global real estate sector. In Japan, the central bank has targeted real estate funds in its quantitative easing agenda, which makes investors less nervous about overstretched valuations. The recent rise in interest rates has had a short term negative impact on the market. The 'search for yield' argument has become less prevalent with rising yields and the negative influence of these on short-term REIT performance. This negative influence is mitigated however as rising rates will eventually boost office space rentals. As we do not envisage a further strong upward movement in capital market rates, this will not hamper real estate performance in our view.

Relative performance of real estate versus global stocks



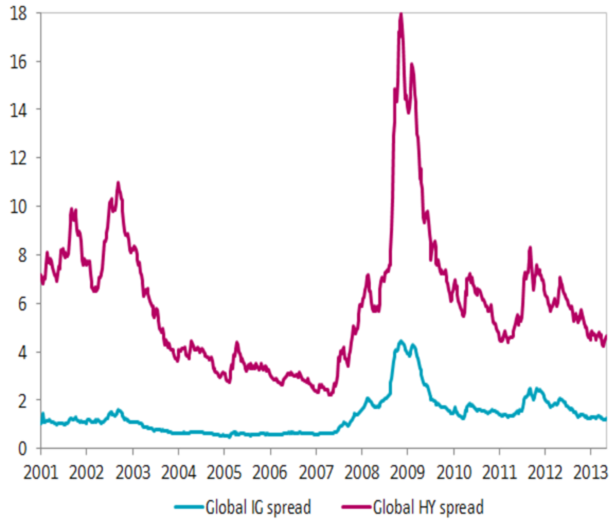
Source: Thomson Reuters Datastream

Credits and high yield

The outlook for high yield remains positive, although the asset class suffered from the market stress. HY declined -3.2% as credit spreads widened by 59 bp to 530 bp. We now more clearly prefer high yield to credits as running yields still offer decent absolute returns as the current low-interest rate environment will prevail and HY had a larger sell-off last month and we expect a rebound. In terms of risk for HY we note that the "covenant lite" issuance has reached an all-time high, although the comparison with 2007 is unjustified because current covenant lite issuance is predominantly used for refinancing rather than leveraged buy outs.

We have a neutral view on credit. The IG credit spread-to -leverage ratio has worsened as corporates have taken on more leverage. In terms of risk factors, the less bondholder friendly environment and higher correlation with country risk imply a more volatile environment for credit.

Spreads for global credits and high yield

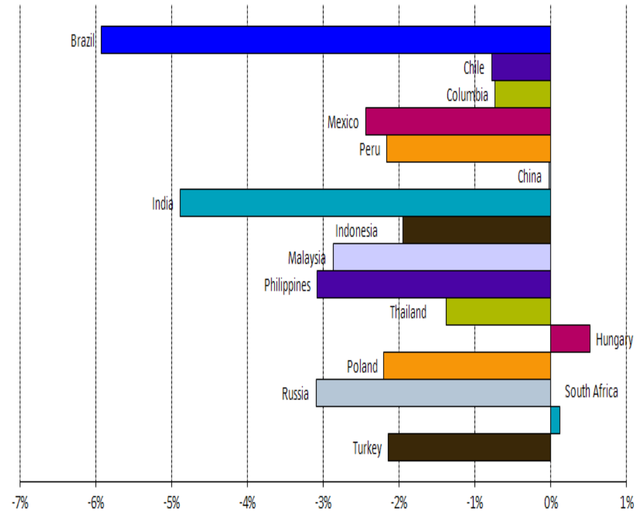


Source: Bloomberg. Robeco

Emerging market debt

We have brought our position back to neutral as we are convinced that HY corporate debt now clearly offers better risk/return perspectives. EMD took a hit last month as spreads widened significantly while EM currencies continued to depreciate against the dollar. Spreads widened due to investor risk aversion resulting from increasing nervousness about Fed tapering. This external risk aversion was further compounded as internal political risk increased in Brazil, South-Africa, Turkey and Egypt. It is uncertain exactly when this civil unrest will abate. We do not expect a meaningful rebound in EM currencies in the short term as the rise in volatility and Treasury rates reduces the EM currency carry. Also, worsening economic fundamentals in emerging markets restrict room for currency intervention. Countercyclical measures in both fiscal and monetary policy are becoming more restrained with fewer countries able to lower rates. Countering currency depreciation with rising interest rates will put further pressure on the already poor growth differential with developed markets. For the long term we remain positive on EM currencies as the valuation is still positive and they still have sufficient ammunition to defend themselves against more extreme capital outflows. The analogy with the Asian crises is therefore unwarranted.

One month dollar returns for emerging market currencies

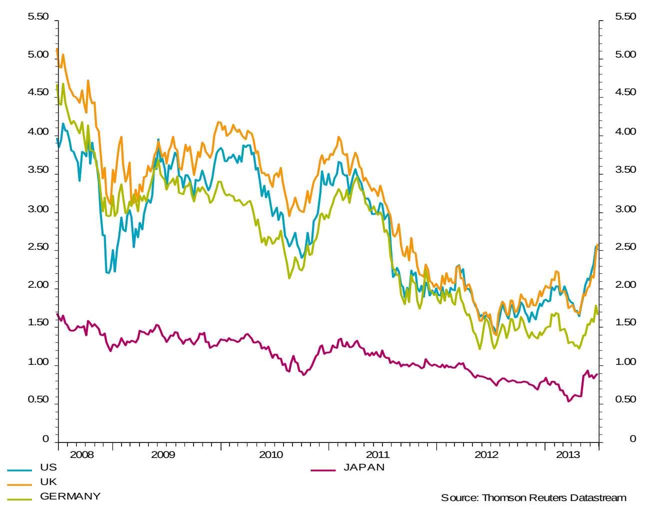


Source: Bloomberg. Robeco

Government bonds

We retain our negative view on government bonds. Bond markets reacted negatively to the news that the Fed might taper its USD 85bn purchases sooner this year than originally expected. The Fed growth outlook for 2014 surprised on the upside by forecasting a stronger US recovery. The ongoing debate in the market is whether the hawkish Fed speech was inspired by worries about financial market bubbles or was intended as a serious signal to the markets to prepare for the end of QE. The market's negative response was tempered by more dovish statements by Fed governors later last month. While the Fed is in the process of conveying its real message to the markets, higher rates will continue to test the resilience of the ongoing recovery in the US. In Japan, the BoJ will keep its strong commitment to weaken the yen and will emphasize the fact that it has ample means to prevent a sell-off in the JGB market. A further rise in global yields is not likely in our view, but government bonds remain the least attractive asset category. We expect riskier assets to outperform government bonds.

Ten year interest rates

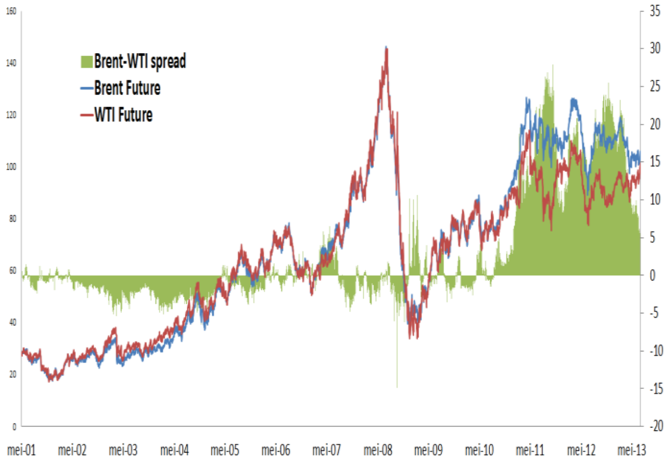


Source: Thomson Reuters Datastream. Robeco

Commodities

We remain underweight commodities. A weakening economic growth outlook in emerging markets, notably China, does not offer near term support for commodities. As most commodities are denominated in dollars, the continuing sharp reversal in emerging market currencies vis-à-vis the dollar supports our view that commodity prices will still experience net downward pressure. There are two key factors which are expected to cause the oil market to move sideways in the near term. On the one hand the non-OPEC production is still increasing. On the other hand the geopolitical risk premium for oil is rising as the unrest in emerging markets (Egypt/Iraq) continues.

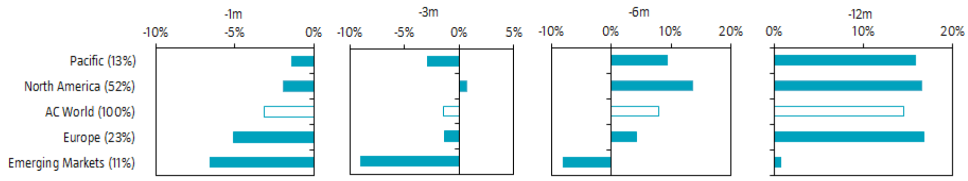
Brent-WTI spread



Source: Bloomberg

Regional allocation

Performance of regions (MSCI AC World unhedged EUR; index weights between brackets)



Source: Thomson Reuters Datastream. Robeco

North America continues to be our favorite region for equities as the economy is doing relatively well. US corporates are still leading the recovery, manufacturing activity expanded further this month while jobless claims continued their downtrend. In addition, we expect the Fed to start tapering in the fourth quarter 2013 at the earliest. Earnings revisions are above average following the first quarter reporting season for most companies. For the Pacific we have a slightly positive view. In Japan, the BOJ's steps to weaken the yen have been successful and it will maintain its current policy stance at least until the Upper House elections in July 2013. This will also benefit equities. At this stage, we expect the yen to weaken further, but we refrain from taking a strong positive view on equities yet as we would like to see more evidence of an economic rebound to support the stock price rises. We remain negative on Europe. The debt crisis in the euro zone is the most important factor and political risks remain. Economic data in the euro zone continue to be weak but are improving, although earnings revisions remain poor. Economic data in emerging markets also continue to be weak, notably the recent money market stress in China which will test the official 7.5% growth target. We do not anticipate an improvement in economic data and therefore feel the underperformance there could continue.

Earnings and valuation data of regions (MSCI AC World)

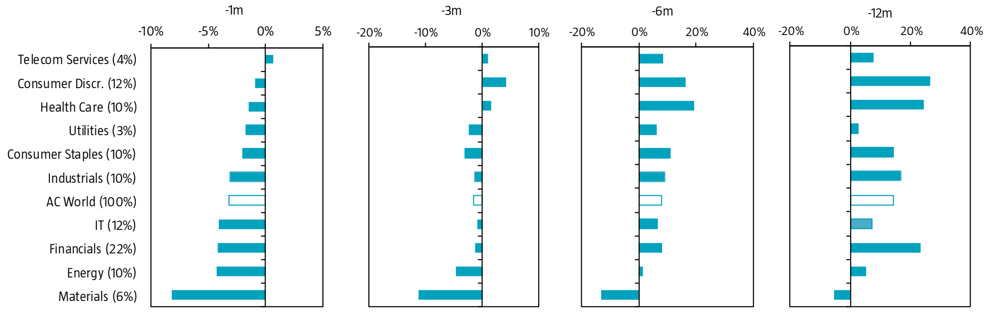
	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	*FY2*	*12m*	*3m*	*1m*	*Current*	*10y avg.*
North America	7.3	10.8	9.9	-2.6	-31.1	13.7	14.2
Europe	1.9	12.2	8.2	-32.3	-63.6	11.4	12.1
Pacific	33.9	10.3	26.2	11.5	-4.3	13.1	15.4
Emerging Markets	11.8	11.5	11.9	-20.9	-31.4	9.2	10.8
AC World	9.1	11.2	11.5	-12.4	-35.6	12.4	13.3

The earnings revisions index is calculated as the difference between the number of up- and downward revisions relative to the number of total revisions.

Source: Thomson Reuters Datastream. Robeco

Sector allocation

Performance of sectors (MSCI AC World unhedged EUR; index weights between brackets)



Source: Thomson Reuters Datastream. Robeco

Defensive sectors such as consumer staples, telecom and utilities rebounded last month. As we think the market is not entirely convinced by the Fed's promises of growth, defensives will remain attractive. Surprisingly strong economic data could again boost outperformance in cyclical sectors, but this seems unlikely to us. Earnings revisions also still favor defensive sectors above cyclical sectors. Finally, the relative performance of defensive sectors tends to be relatively strong in the May through October period. In short, we expect the outperformance of defensive stocks to continue.

Earnings and valuation data of sectors (MSCI AC World)

	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	***FY2***	***12m***	***3m***	***1m***	***Current***	***10y avg.***
Energy	1.1	8.3	5.4	-11.7	-43.4	9.9	11.1
Materials	3.9	17.4	15.7	-50.5	-56.3	11.4	12.3
Industrials	10.3	14.1	13.6	-23.0	-43.9	13.2	14.4
Consumer Discr.	17.7	12.5	17.3	4.4	-14.5	13.8	15.4
Consumer Staples	8.1	10.2	9.7	-28.6	-66.5	16.2	15.8
Health Care	0.5	9.5	5.8	-12.3	-3.7	14.7	14.5
Financials	12.8	10.2	11.5	5.9	-29.3	10.8	11.4
IT	10.9	13.1	14.2	-6.4	-21.6	12.4	16.6
Telecom Services	4.5	8.6	7.3	-6.9	3.0	12.6	15.0
Utilities	25.8	7.6	20.5	15.1	40.0	13.2	13.7
AC World	9.1	11.2	11.5	-12.4	-35.6	12.4	13.3

The earnings revisions index is calculated as the difference between the number of up- and downward revisions relative to the number of total revisions.

Source: Thomson Reuters Datastream. Robeco

Closing date text: 03 July 2013.
We refer to calendar months in all our data tables.

Important information