ROBECO

Monthly Outlook

Liquidity-driven rally to continue

In this issue

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Speed read

- Surprise ECB rate cut expected to boost risky assets
- Tactical asset allocation changed
- Short position in bonds and long equity exposure increased
- The euro shorted versus the US dollar
- Strong Q3 GDP US is unlikely to speed taper
- High yield remains our favorite fixed income asset class

INCREASE IN OVERALL RISK PROFILE

Following the surprise decision by the European Central Bank (ECB) to lower its main lending rate and overnight rate by another 25 basis points, and to make unlimited loans available to banks for a year longer, we have raised our recommended overall risk profile. We expect the current liquidity-driven rally to continue for several months.

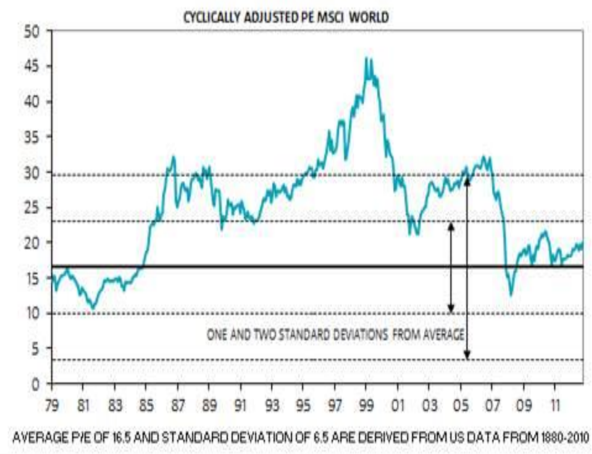
Underweight in bonds increased

The ECB rate cut pushed bond yields lower, but we don't think this will be the case in the near term. We expect yields to gradually normalize from here. Economic growth is picking up globally and, although the US Federal Reserve (Fed) has postponed tapering for now, it will probably start reducing its bond-buying program in the first quarter of next year. The strong downward pressure on bond yields that we have seen over the last couple of years will start to end. As German and US bond yields are closely correlated, bond yields in Europe will also start to normalize gradually. With the latest rate cut by the ECB we think yields have been pushed to the lower end of the range and will start to rise from here.

Overweight in equities increased

We have become more constructive on equities as major risks have diminished while excess liquidity will remain around for longer. Several perceived risk factors, notably volatility spurring from plans for tapering, military intervention risk in Syria, the German elections and the US government shutdown, all passed without endangering the recovery. However, the US shutdown did distort the macro data, shifting market expectations for tapering to Q1 2014, leaving more excess liquidity around for longer in the economy. Sizeable corrections have been absent: the last 10%-correction in US stocks dates back to mid-2012. It is not unusual to see these kinds of long-dated rallies, especially during periods of very accommodative monetary policy. The steady rise in stocks (in excess of earnings) has made equities more expensive, but we are not in the exuberance phase. Momentum is positive, our in-house econometric models are long equities, and the macroeconomic data suggest a strengthening world economy. Last, but not least, the seasonal pattern has turned positive for stocks.

Equities not overly expensive on basis of Shiller P/E



Source: ThomsonReuters Datastream, Robeco

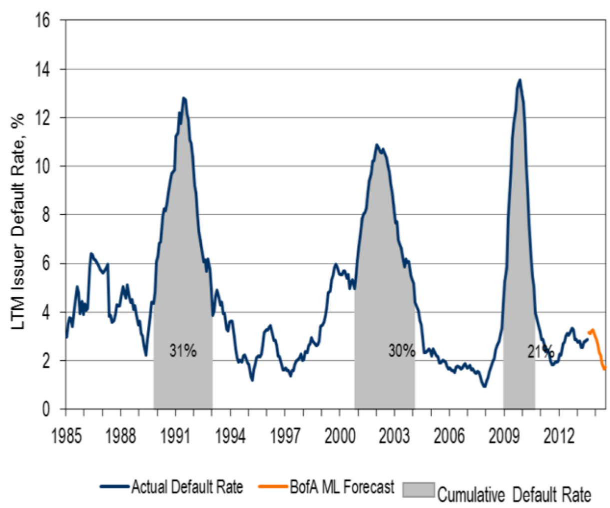
Short euro/long dollar

The ECB rate cut can be viewed as an instrument to fight the natural forces that drive up the euro like the positive current account surplus, the shrinking central bank balance sheet and disinflationary trends. With US tapering only postponed until next year and certainly not cancelled, we expect the US dollar to strengthen against the euro. The global currency war is in full swing and the ECB just added a bit of artillery.

Within fixed income, high yield remains the most attractive asset class

We retain our positive view on high yield, where spreads compressed considerably by 43 basis points last month. Spreads have therefore dropped further below their long-term average. Nevertheless, the determinants for the spread remain in good shape. Recovery rates are high and default rates are expected to decline further in the course of 2014 to historic lows (just below 2%). The ongoing economic recovery, from low levels, and timid inflation especially favors high-yielding corporate bonds. Also, healthy interest coverage ratios and well mitigated refinancing risk will contribute to a further drop in default rates. However, we remain alert on the increased 'covenant lite' issuance as well as the more volatile character of the HY market in general. Liquidity for this asset class is relatively modest, causing more potential for price swings.

HY default rates expected to fall



Source: BofA ML

Model portfolio and outlook for other asset classes

Preferences within equity portfolio

We have become less constructive on North America as earnings revisions have deteriorated, necessitating strengthening economic growth, while valuations look relatively stretched. Europe looks currently more favorable to us as the improved macro data has not been fully translated into relative equity performance. Also, the interest rate cut by the ECB could give European equities additional support. We retain our positive view on the Pacific region. An accommodating Bank of Japan (BOJ) will push for further yen weakening which should help the country's economic performance. Earnings revisions are above average and valuations are favorable. We remain neutral on emerging markets as earnings growth and valuations are improving, although we do not anticipate a significant improvement in economic data, as policy room to counter the current cyclical deceleration is limited. Earnings revisions also remain poor, though we believe the downward potential relative to other regions is increasingly limited. We maintain a preference for cyclical versus defensive sectors. From a macroeconomic point of view, the delay in tapering should be positive for cyclicals, particularly as we also believe that the impact of the US shutdown will be quite limited. Earnings revisions do not clearly favor cyclicals or defensives, but relative momentum favors cyclicals.

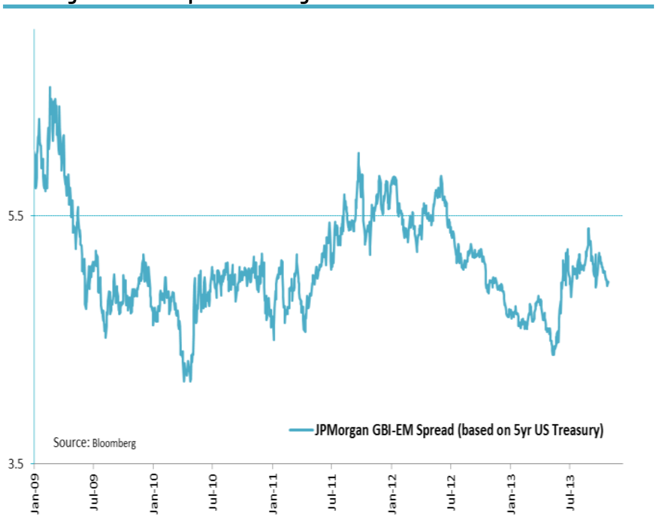
Real estate

We remain negative on real estate as we expect the prospect of tapering will continue to dominate its performance relative to equities, and the reduction of excess liquidity will gradually begin in the near term. As we also expect higher yields, as developed world economies improve, real estate is on a slippery slope. Given the high sensitivity of real estate to higher bond yields, any future rate rises will harm its performance. The increase in house prices in the US has slowed due to rising mortgage interest rates since May. Hong Kong, an important mortgage market, will face excess supply next year, putting pressure on prices. Dividend yields for Real Estate Investment Trusts (REITs) have declined because higher interest rates make them less attractive than other risky assets. Despite the recent decline in prices, valuations in real estate are not cheap relative to equities.

Emerging market debt

We maintain our neutral position as high yield offers better risk-return perspectives, although emerging market debt saw some spread compression last month, contributing to the recent uptick in performance. Moreover, as rates volatility has abated through the postponement of Fed tapering, emerging currencies have shown positive momentum for the first time this year. With less pressure on interest rates, emerging countries have more time to build foreign currency buffers and carry out necessary economic reforms. The economic resilience of emerging markets has not been the dominant theme for these countries in recent months, but it may shift back into focus in the absence of heightened market volatility about earlier-than-expected tapering. Currency appreciation remains the major contributor of emerging market debt returns. The vulnerability of emerging market economies to capital outflows remains an issue. Fiscal consolidation and improving current account balances remain an important step to mitigate the vulnerabilities emerging from externally financed debt. Emerging markets intend to launch a common fund to

JPMorgan GBI-EM spread has tightened somewhat



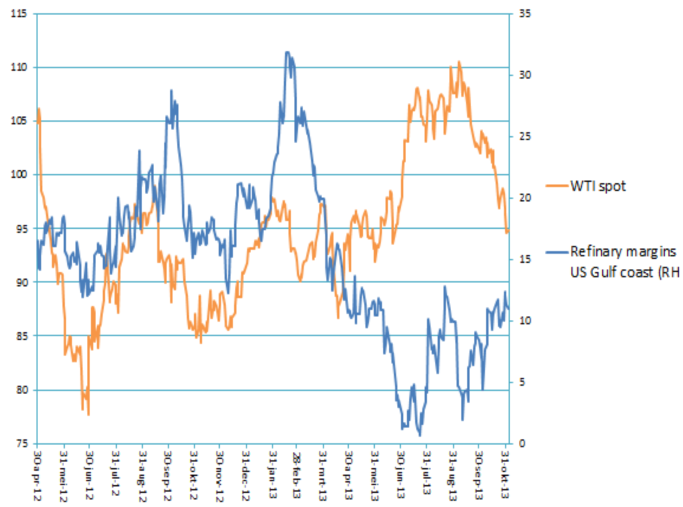
Source: Bloomberg, Robeco

act as a buffer against the withdrawal of global excess liquidity as monetary easing in the developed world will gradually be unwound. The fund will neither be timely nor sufficient in our view, maintaining the case for further fiscal consolidation and domestic reforms. We expect continuing divergence within emerging markets according to differences in export orientation, current account balances and fiscal and monetary policies.

Commodities

We remain neutral on commodities. Metal prices rebounded, lifting the equity prices of miners. Energy prices declined further, sustaining refinery demand and leaving unusual low refinery outages of 4% of global operating capacity. WTI oil prices moved jointly lower with the decline in 10-year US real interest rates on market concerns about the growth impact of the US shutdown. However, we expect this impact to be moderate, creating upward pressure on real interest rates, shifting WTI higher. Also, supply outages in Libya, Iraq and Nigeria will prevent a further slide in oil prices, especially Brent. Geopolitical risk has abated further with more promising diplomatic moves by Iran. Nevertheless, low volatility in oil prices may prove to be temporary given that geopolitical risks have not vanished. Although the current negative momentum effect could justify a modest underweight position, from a macroeconomic perspective, maintaining a neutral position in commodities is more appropriate, especially given a rebound in Chinese growth.

WTI versus refinery margins



Source: Bloomberg

Robeco's multi-asset model portfolio

	Portfolio	BM	active	previous
Equities - Developed Markets	27.5%	25.0%	2.5%	1.0%
Equities - Emerging Markets	5.0%	5.0%		-1.0%
Real Estate Equities	4.0%	5.0%	-1.0%	-1.0%
Commodities	5.0%	5.0%		-1.0%
Core Gov Bonds 1-10-year	14.0%	20.0%	-6.0%	-4.5%
Core Gov Bonds 10-year+	7.5%	7.5%		
Investment Grade Corp Bonds	20.0%	20.0%	0,0%	0,0%
High Yield Corp Bonds	10.0%	5.0%	5.0%	5.0%
Emerging Market Bonds local currency (LC)	5.0%	5.0%		
EUR Cash	2.0%	2.5%	-0.5%	-0.5%
EUR/USD	-4.0%	0,0%	-4.0%	-2.0%
EUR/JPY	2.0%	0,0%	2.0%	2.0%
EUR/GBP				

Portfolio risk	6.62%	6.16%
Sum of individual tracking errors	1.63%	
Portfolio tracking error	0.62%	

Macroeconomic outlook

ECB joins currency war

The ECB surprised markets with an unexpected preemptive strike. Probably triggered by the slide in headline inflation towards a worrisome 0.7%, and the relative, unwelcome strength of the euro, the ECB cut its main financing rate to 0.25%. It also extended by another year the availability of unlimited loans to banks until mid-2015. It kept its deposit rate unchanged at 0%, but ECB President Mario Draghi made it very clear that the central bank is technically capable of moving the rate into negative territory if the need arises, which would be another unprecedented, unconventional step. Furthermore, Draghi stressed that the ECB has other weapons in its arsenal. The monetary policy decision was not unanimous and resisted, among others, by Bundesbank President Jens Weidmann. All in all the more aggressive approach of the ECB diminishes deflationary risks for the Eurozone, is positive for the UD dollar, and will contribute to the current feeble economic recovery in the single currency area.

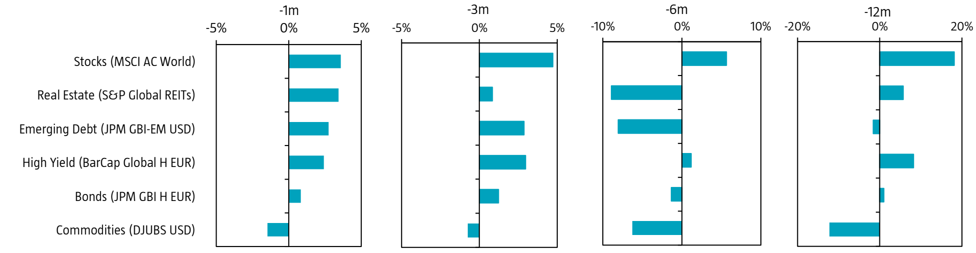
US tapering is a matter of time

The US economy showed unexpected strong headline numbers for GDP growth for the third quarter. The economy grew 2.8% on an annualized basis versus 2.5% in the second quarter. However, the stronger growth can mainly be attributed to restocking business inventories. Apart from this, consumer spending growth was low, and companies have cut back spending on equipment. Investment growth on the whole accelerated somewhat, but this was largely due to the strength of the housing sector. The GDP figures do not suggest a strengthening of the US economy, which seems to struggle forward at a 2% pace. It will not be a trigger to speed up US tapering. The non-farm payroll figures for October (and the positive revision for September) on the other hand were remarkably strong, suggesting that the damage caused by the temporary showdown of the US government is limited, and the underlying strength of the US economy is healthy, which would increase the case for an early introduction of tapering. It is unlikely to occur in December however, as market liquidity is limited after Thanksgiving in late November. But the end of January - the last Fed meeting under the chairmanship of Ben Bernanke - remains a possible date. We believe the likelihood of a second shutdown of the US government in early 2014 or renewed tensions about a possible default of the US government are both small. After the stunning political defeat of the Republicans in mid-October, it is unlikely that politicians will gear themselves up for another fight of the same magnitude. Moreover, Republicans need to end the current process of sequestration as defense spending will otherwise be severely hit in 2014, hurting primarily Republican interests. Recent political developments also show a clear preference by the US electorate for pragmatism. We therefore expect some kind of a deal in due course.

Chinese economy strengthens, Communist Party Congress is hyped up

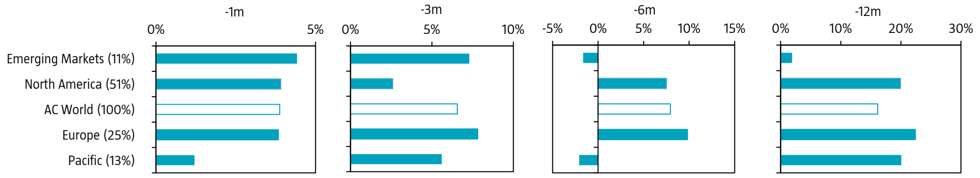
In China the growth of the service sector accelerated last month. Moreover, activity in Chinese factories accelerated at its fastest pace for 18 months during October, according to the government's purchasing managers' index. The index hit 51.4, up from 51.1 in September. As production is outpacing the rise in new orders, the sustainability of this recovery in the medium term is weak. On 9 November, the Communist Party began a major conference. Some observers expect new Chinese President Xi Jingping to take major decisions on reforms to liberalize the financial sector, shore up shaky budgets in local governments, and relax the unpopular hukou household registration system. We think this is overhyped, as implementing these reforms will be difficult in the current environment of sluggish growth.

Performance of asset classes (gross total return)



Source: ThomsonReuters Datastream, Bloomberg, Robeco

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



Source: ThomsonReuters Datastream, Robeco

Consensus estimates of economic growth and Robeco's expectations

GDP growth by region (%)	*2012*	*2013*	*2014*	*Δ -1m 2013*	*Robeco**
US	2.2	1.6	2.7	-0.5	+
Eurozone	-0.5	-0.4	0.9	0.0	=
UK	0.2	1.3	2.1	0.6	=
Japan	1.9	1.9	1.7	0.6	=
China	7.8	7.5	7.4	-0.6	+
India	5.0	4.9	5.9	-1.2	-
Brazil	0.9	2.2	2.7	-0.9	-
Russia	3.4	2.3	2.9	-1.0	=
World	2.2	2.0	2.9	0.0	=

* 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	1.5	1.9	-0.3	=
Eurozone	2.5	1.5	1.5	-0.2	-
UK	3.2	3.1	3.0	-0.3	=
Japan	0.0	0.1	2.2	0.1	=
China	2.6	2.6	3.0	-0.6	+
India	10.3	8.8	7.6	0.6	-
Brazil	5.8	5.8	5.6	0.2	=
Russia	6.6	6.0	5.5	0.1	=
World	2.6	2.0	2.4	0.0	-

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

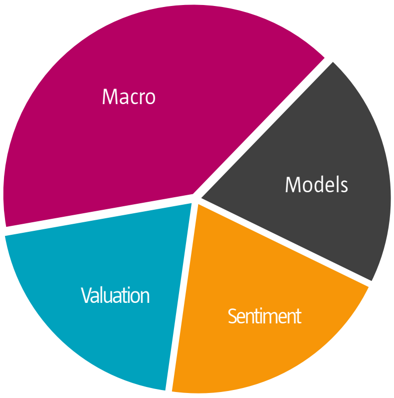
Source: Consensus Economics, Robeco

Robeco's multi-asset management approach

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 valuations 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



Closing date text: 08 November 2013.
We refer to calendar months in all our data tables.

Important information