



Emerging markets unsettle investors

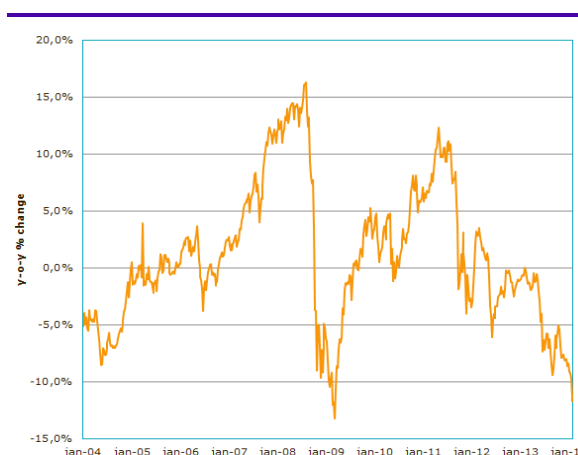
- Fed won't change course for the time being
- China is the real worry in the coming months
- We are now underweight emerging market debt

Topic of the month: China is the wild card

The unexpected and brutal sell-off in emerging market equities poses some important questions for investors. Will the US Federal Reserve (Fed) change course, shortly after tapering its bond-buying program has started in earnest? Will the recovery in advanced economies be derailed by the growing problems in selected emerging markets? Do current events materially change our view on the performance of asset classes in 2014? The short answer to these questions is **no** - unless China weakens considerably.

The phrase "currency war" was coined by the Brazilian finance minister Guido Mantega in September 2010 in response to quantitative easing by the Fed, potentially unleashing a tsunami of capital flows towards emerging markets. Ironically, "currency peace" is at hand, now that the Fed seriously has started to taper, an event which is probably even less applauded by Mantega. On 29 January, the Fed announced a further measured reduction in the pace of its asset purchases beginning in February, cutting another USD 10 bln from its monthly tally. Slowly, the Fed is normalizing monetary policy in the light of the pick-up in economic growth in the US, though its balance sheet is still expanding.

Collapse of JP Morgan Emerging Currency Index (% YOY)



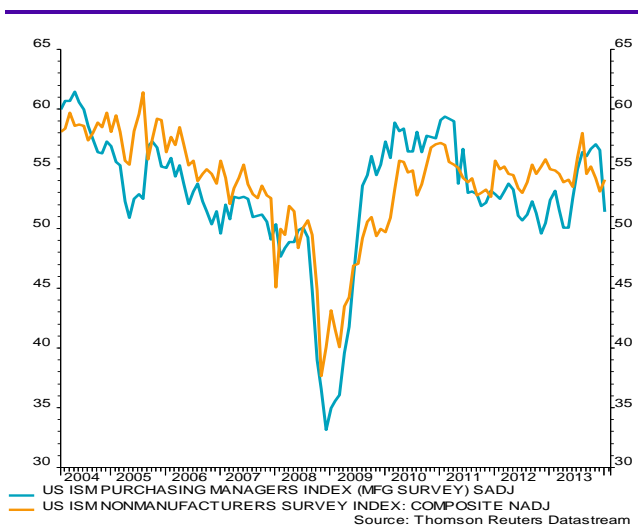
In our opinion it is unlikely that the Fed will change course quickly, despite the increased volatility in financial markets and the sell-off in selected emerging currencies. Firstly, the current strength of the US economy is probably underestimated. Fourth-quarter GDP growth was once again a positive surprise, as was the third-quarter figure. The US government won't be a drag on growth as in 2013 due to severe sequestration (where it is legally obliged to cut the deficit by reduced spending). Disappointing December payroll figures and a surprisingly weak

January manufacturing PMI reading are probably one-off distortions caused by an unusually cold winter in North America. By contrast, the non-manufacturing PMI rose in January to 54.0 from 53.0 (a figure above 50 indicates growth), suggesting further strengthening. Domestic considerations, therefore, point toward continued moderate tapering at a rate of USD 10 bln per Fed meeting. It has been pointed out that the Fed's explanatory statements don't refer to the turmoil in emerging markets, unlike more tactful statements by the European Central Bank. It would be unfair, however, to accuse the Fed of taking a parochial view. The Fed is well aware of the external impact of its policies, but in the highly polarized political atmosphere in Washington, it prefers to communicate within the limits of its mandate.

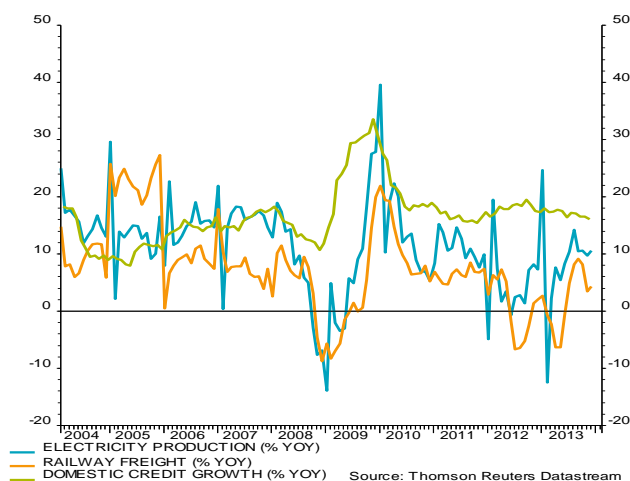
It's not all down to the Fed

Secondly, the current problems in selected emerging markets cannot be primarily attributed to the tapering decisions of the Fed. The policy mix has been too loose, as suggested by factors such as the current account deficit of Turkey rising to more than 7% of GDP. The phrase 'fragile five' was coined to highlight the vulnerability of Brazil, India, Indonesia, South Africa and Turkey due to their current account deficits. The policy mix has to change, though it would be a bad idea trying to stabilize exchange rates vis-à-vis the US dollar by hiking interest rates prohibitively high. The weakening of emerging market currencies will contribute to a rebalancing of their economies and a lowering of current account deficits. Weaker growth in selected emerging markets will therefore be unable to derail the ongoing recovery in developed markets. Their economic clout is too small. It could of course contribute to a weakening of commodity prices, which would further strengthen the recovery in advanced economies.

Collapse in US ISM manufacturing probably a blip



Chinese Premier Li Keqiang's preferred indicators suggest growth in the Chinese economy is bottoming out

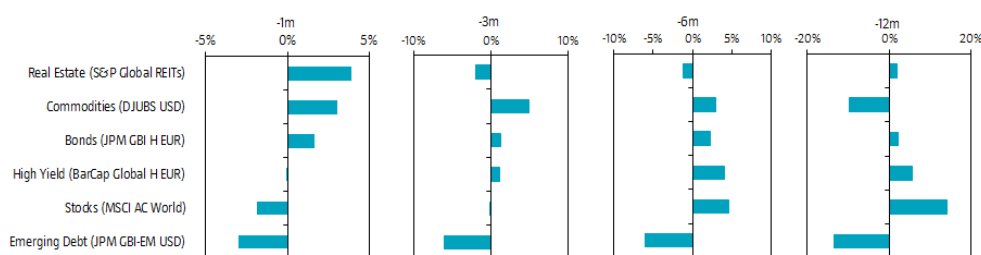


China is the real wild card

Things could become different however if the Chinese economy materially weakens further, due to its size. The Chinese authorities have slowed down economic growth recently in an effort to curb housing prices and tame the shadow banking system. More importantly, they presented at the latest Communist Party Congress an ambitious reform program, which in practice would mean lower structural growth. But it is unclear what may eventually happen. In 2013 the Chinese leadership demonstrated a very low tolerance for a growth rate below 7%. We therefore expect China to strive for a similar growth rate for 2014 and to pump up growth if it is deemed necessary. With foreign reserves exceeding 40% of GDP, a structural budget surplus, massive domestic savings and a relatively low central government debt, Chinese policy makers have ample room for maneuver. But the policy preferences of the Chinese leadership are unclear. An assessment of the current state of the Chinese economy is further complicated by the Chinese Lunar New Year, which makes the interpretation of the trend in economic data in the coming two months especially complicated. China therefore remains a wild card in the coming months.

Asset allocation – stock market rally is set to continue

Performance of asset classes (gross total return) – stocks ruled in 2013



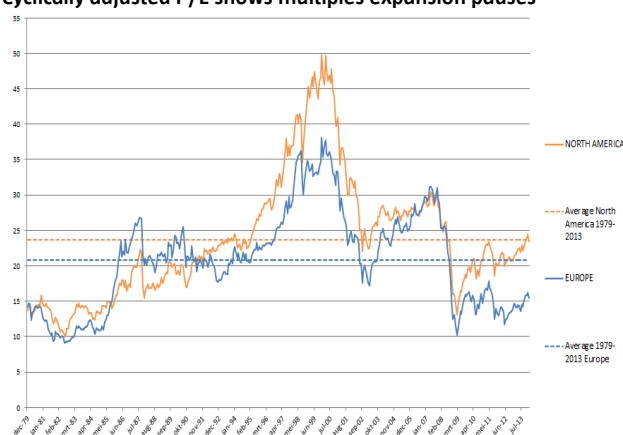
Source: Thomson Reuters Datastream, Bloomberg, Robeco

Equities remain our favorite asset class

In contrast to the previous year, equities made a cumbersome start to 2014, with the MSCI AC World in EUR declining 1.9% in January. The recent performance of equities shows that the market is digesting the deceleration in emerging markets and the tapering of bond purchases by the Fed. The gradual return to monetary normality in the developed world has caused distress in emerging markets, although this is only part of the story. The growth deceleration of emerging markets has been lingering for a long time but became more prominent last month after several sources of volatility were triggered. Disappointing manufacturing data from China, political unrest in Turkey and depreciation of the Argentinian peso led to a broad sell-off in emerging markets. The unrest partly spilled over to developed markets, which were additionally confronted with disappointing US manufacturing figures, although bad weather likely distorted the reading to a certain extent.

After the strong, almost uninterrupted price/earnings multiple expansion over the last 500 days, the current market movement shows increased nervousness about earnings growth lagging price appreciation against the background of a slowing momentum in the US. Also, the Fed contributed to

Cyclically adjusted P/E shows multiples expansion pauses



Source: Thomson Reuters Datastream, Robeco

market volatility by indicating that it will continue to taper at its current pace, which would lead to a slower expansion of global liquidity in the near term. The slowing momentum in the US economy and lower Treasury rates ease the forward guidance pressures for the Fed. We think that equity risk premiums in emerging markets could remain elevated given the wild card of China, which is deemed more important compared to tapering.

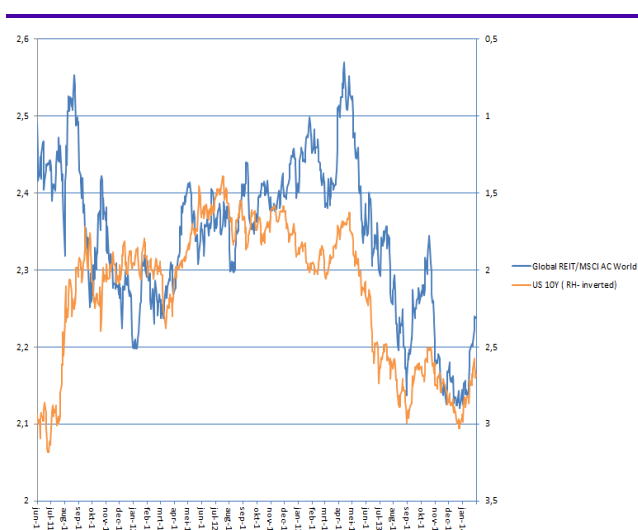
We remain overweight equities as we continue to believe that the recovery won't be derailed by the current volatility in financial markets. Also, the recent rally in rates eases the job for new Fed President Janet Yellen in convincing the markets that the unwinding of QE is not synonymous with rate increases. The message of low rates for a 'considerable time' will sustain the search for yield and rekindle growth. We expect a more sideways movement in profit margins as accelerating economic growth will lead to higher capital expenditure, while low refinancing risk and the virtual absence of labor pricing power will sustain high margins for longer. Earnings revisions have not been improving on a 3-month horizon, with the exception of net positive revisions in Asia Pacific. Profit margins seem stretched in the developed world, now at almost 9% for the S&P 500 companies.

Real estate was the best performer in January

Real estate was the best performing asset class in January as a result of its defensive characteristics within a deteriorating risk-on sentiment. However, for the near term we remain negative on real estate compared to equities as the asset class remains vulnerable to rising interest rates. US interest rates in our view will rise towards 3.5% this year. The impact of rising rates will however be cushioned to the extent that real rate rises signal accelerating economic growth, which eventually translates into lower vacancy rates and rental income.

From a valuation perspective, real estate is still expensive compared to equities, although this valuation gap is compensated to some extent by higher dividend yields. There remain substantial differences in regional valuations, with the US and Japanese markets more expensive compared to Europe. However, some segments in the Japanese market are assured of a structural buyer, the Bank of Japan, sustaining a certain level of demand. Dividend yields in the US, Europe and US are above dividend yields for equities.

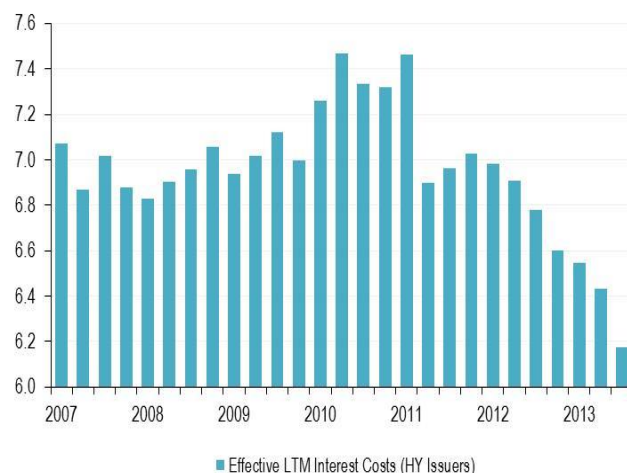
Real estate has outperformed equities



High yield is still attractive thanks to low defaults

We retain our positive view on high yield despite the more risk-averse sentiment. Spreads widened as risky asset correlations increased, although the decline in capital market rates secured a net positive performance over the month. As we expect a low but increasing interest rate environment, high yield retains its attractiveness compared to other asset classes, and the recent rally in rates did not erode the spread buffer further. Strong interest coverage ratios, low refinancing risk and accelerating growth in developed markets will keep default rates low. In addition, recovery rates remain high. Consequently, high yield spreads can compress further, although the remaining upside is more limited because of below-average spreads and fewer bond-friendly activities. We keep a watchful eye on the increased leverage of high-yield companies. The increased 'covenant lite' issuance as well as the more volatile character of the high yield market in general could become a drag on performance. Broker liquidity for this asset class is relatively modest, creating more potential for price swings. Nevertheless, we prefer high yield compared to credits. Corrected for risk, the 6% yield on high yield remains more attractive than the ultra-low rates on investment grade corporates (1.9%). We remain cautious on financial credit as well because the current spread does not reflect the possibility of stress tests having an adverse impact on the banking sector later this year. The high correlation of credit with core government bond markets in the periphery remains a risk.

Interest costs for high yield companies have fallen since 2011

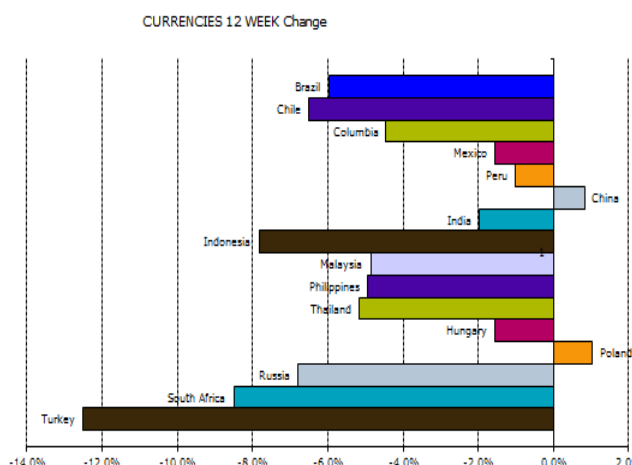


Source: Bloomberg

Currency factors dominate emerging market debt

We are now underweight in emerging market debt (EMD) against high yield given the sell-off in emerging currencies which will remain in the firing line for months to come. EMD had a cumbersome year in 2013. Yields rose, currencies weakened, and returns disappointed. Investors who had entered the market expecting stable and predictable bond-like returns found out the hard way that due to the currency component, EMD volatility lies markedly above high yield volatility. We feel that the EMD market does not yet price in a sufficient risk premium for this unwanted volatility, which is why we have now decided to underweight the asset class. The deceleration in emerging markets growth and, to a lesser extent, Fed tapering caused a broad sell-off in emerging market currencies in January, with the Turkish lira declining 7.8%. Sluggish structural reforms and election risks will likely prevent a meaningful rebound in the near term. We need to see significant improvements in current account deficits and a further decline in external debt vulnerability. Also, structural rebalancing, lower commodity prices (often still a major source of income for these countries) and stubbornly high inflation in nations such as Indonesia and Brazil) hamper economic growth. Structural reforms are under way, but this long-term gain will cause short-term economic pain as well as rate hikes to prevent further capital outflows. The structural reforms themselves could be hampered in a year that will see elections in key countries. We expect continuing divergence within emerging markets according to differences in export orientation, current account balances, fiscal- and monetary policies and political stability.

A notable sell-off has occurred in emerging market currencies



Source: Bloomberg, Robeco

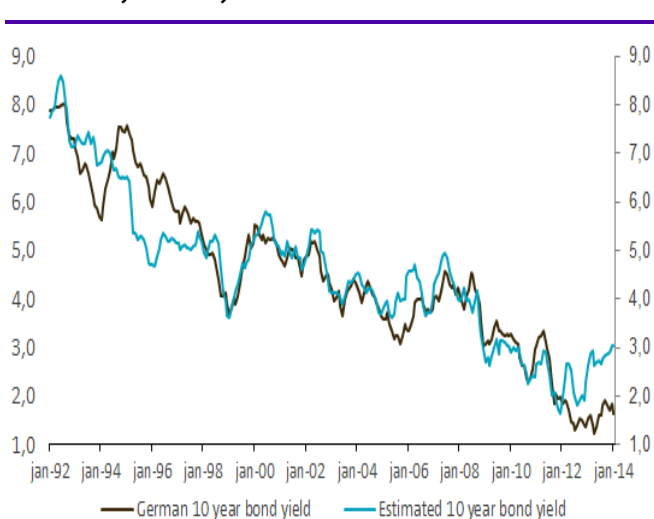
Government bonds are set to fall in value

Despite the generally held fear of the impact of tapering on core government bonds at the start of the year, January unexpectedly proved to be a strong month for sovereigns, returning 1.7%. The increased stress in financial markets after signals of a China slowdown increased demand for safer assets like core government bonds, intensified by a disappointing US manufacturing activity reading for the month. The 10-year US Treasury rate declined in response from 3.0% to 2.6% during the month. We remain negative on core government bonds in the near term as we expect the spillover effects from the emerging markets sell-off to developed markets to abate, and we believe that the slowdown in macro momentum in the US is largely

weather related. We think that the US political gridlock has been resolved and the next edition of the debt ceiling debate will not prove problematic. Meanwhile, the Eurozone has seen progress on the institutional reforms side. The preliminary verdict of the Karlsruhe court decision on the legality of Outright Monetary Transactions (OMT) disappointed somewhat, but we think the final German verdict will weaken but not take away the safety net that OMT has provided. Spain and Italy have less need for a safety net and the European Central Bank (ECB) could in a worst case scenario enact a form of unconditional QE. From a fair value perspective, interest rates in the current low or negative yield environment should trend higher, causing downside for bond prices from their currently overvalued levels.

The steadily improving world economy will translate into higher nominal interest rates despite the disinflationary trend observed in some developed countries, notably within the Eurozone. The Fed decision to continue tapering its Treasury purchases will sustain the gradual normalization in interest rates. The tapering path will not likely be changed from the current pace of USD 10 bln/month, even as the influential non-farm payrolls growth figure for January disappointed with only 113,000 new jobs created. The US unemployment rate improved while the labor force participation rate at 63% did not decline further. Other fixed income classes like credit and high yield have better relative risk/return profiles. We therefore prefer corporate bonds compared to government bonds as high yield provides a decent spread buffer against rising interest rates.

German 10-year bond yield is still well below fair value

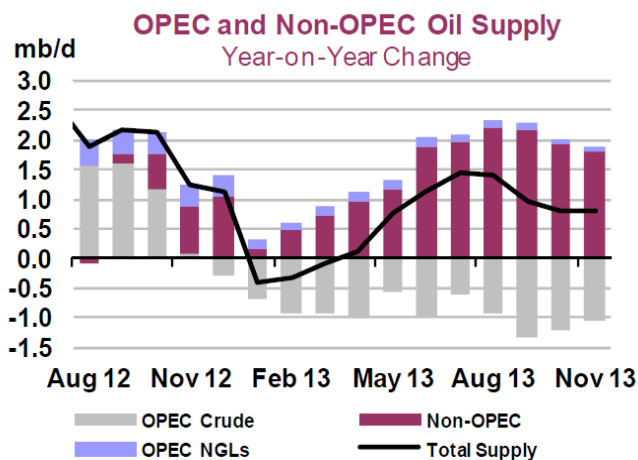


Source: Bloomberg, Robeco

Commodities remain ‘stuck in the mud’

We remain neutral on commodities despite a stronger performance by the asset class in recent months. Supply and demand fundamentals are more or less bearish, but this is compensated for by more favorable idiosyncratic events and the continuing recovery in the global economy. A harsh winter in the US caused gas prices to climb above USD 7.9 per BTU (British Thermal Unit), cutting gas inventories. The oil market has seen ample supply with non-OPEC production expanding at a surprising rate. Oil consumption will likely rise in developed countries as consumer confidence improves, but the deceleration in emerging markets is likely to cause some backdrop in demand in the near term compared to expectations. Also, refinery demand has been stretched. With the refinery maintenance season beginning around March, refinery demand could show a seasonal drop. Nevertheless, we think that oil prices will only drift lower at a moderate pace. Firstly, geopolitical risk is not completely off the table, with continuing supply disruptions in Libya and Iraq. Secondly, elevated breakeven prices for oil at key OPEC members like Saudi Arabia (USD 90/barrel) will put a floor on the market. We hold the view OPEC will preemptively cut supply before these price levels come into sight. Gold prices have stabilized after the increased risk-off mode in financial markets. As the price behavior of the asset class becomes less and less macro- and liquidity driven, the supply/demand picture indicates that commodities still remain largely ‘stuck in the mud’.

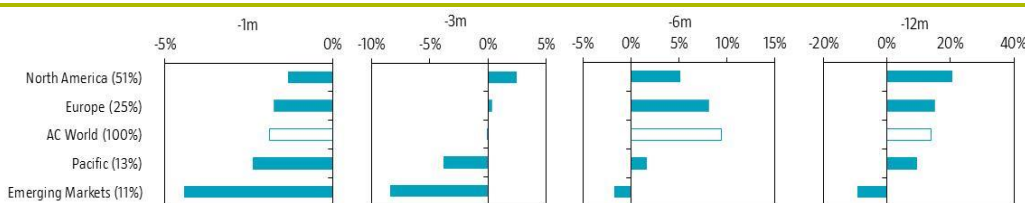
Non-OPEC production has been rising



Source: IEA

Regional asset allocation – Europe is preferred to US

Emerging markets show negative momentum



MSCI AC World unhedged EUR; index weights between brackets

Source: Thomson Reuters Datastream, Robeco

We have become more positive on emerging markets as we hold the view that the relative valuations have become favorable enough to justify a more neutral stance. Also, the country composition of emerging market equities is less sensitive to the recent currency-driven sell-off in the broader asset class. Equities are to some extent hedged for a decline in currency values, in the sense that a weaker exchange rate boosts the earnings outlook for the relevant country, as recent yen weakening in Japan has shown us. We remain less positive on North America, as declining macro momentum and weak earnings revisions did not indicate that earnings growth will be enough to justify stretched valuations. We want to see accelerating economic growth translate into earnings growth to compensate for the high multiples before becoming more positive again. Europe currently remains favorable to us as the macro environment in the periphery keeps improving, while increased competitiveness should strengthen exports and put less emphasis on austerity. Also, the current disinflationary trend in the Eurozone keeps pressure on the ECB to maintain a very accommodating monetary stance. Momentum and capital inflows to Europe remain strong as Spain and Italy were

the only sizeable countries to post positive equity performance in January. A risk we see with regard to equity exposure in the Eurozone remains the toughness of the ECB stress test for weak banks and the possible contagion risks stemming from any defaults.

We retain our positive view on the Pacific region and feel even more comfortable with the current overweight as we think the recent correction in Japan’s Nikkei Index was exaggerated in reaction to the deterioration in risk sentiment. Although recent yen appreciation could further limit upward corporate earnings revisions for Japanese exporters, we think an accommodating Bank of Japan will push for further yen weakening, which should help the country’s economic performance, despite the negative impact of the proposed VAT hike in April. Furthermore, the Pacific region was the only one which posted positive 3-month earnings revisions. Valuations are now more comfortably below their 10-year averages.

The Pacific region has the highest earnings growth

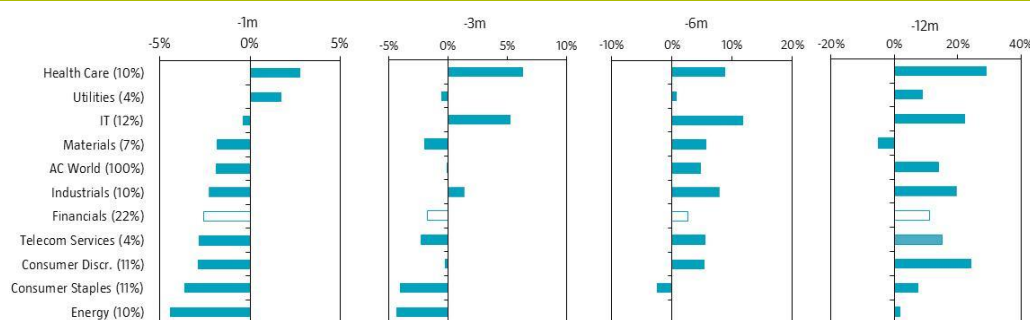
	<u>Earnings growth (%)</u>			<u>Earn. rev. index</u>		<u>P/E on 12m fwd earn.</u>	
	<i>FY1</i>	<i>FY2</i>	<i>12m</i>	<i>3m</i>	<i>1m</i>	<i>Current</i>	<i>10y avg.</i>
North America	5.8	8.9	9.3	-14.7	-15.6	15.0	14.0
Europe	-4.6	12.4	12.2	-29.4	-35.4	13.4	11.9
Pacific	37.4	8.8	12.7	4.8	7.4	13.8	15.2
Emerging Markets	10.6	10.9	10.7	-18.5	-26.9	9.9	10.8
AC World	6.5	10.1	10.6	-18.3	-20.7	13.7	13.2

Earnings and valuation data of regions (MSCI AC World). The earnings revisions index is calculated by using the difference between the number of up- and downward revisions relative to the number of total revisions.

Source: Thomson Reuters Datastream. Robeco

Sector allocation – we are neutral on sectors

Defensive stocks have rebounded



MSCI AC World unhedged EUR; index weights between brackets

Source: Thomson Reuters Datastream. Robeco

At this point in time, we do not have a preference of cyclical over defensive sectors and maintain our neutral stance, as current market sentiment searches for direction about the economic impact of the poor US weather, uncertain Chinese growth and the whole tapering issue. Momentum for cyclical stocks that may benefit most from stronger growth has not accelerated. Also, from a macroeconomic point of view, we note a deceleration in upward macroeconomic surprises which tend to be closely correlated with the performance of cyclicals. Earnings revisions also have proven to be a mixed bag.

Cyclical sectors versus defensive sectors - a mixed bag of growth expectations

	Earnings growth (%)			Earn. rev. index		P/E on 12m fwd earn.	
	FY1	FY2	12m	3m	1m	Current	10-yr avg.
Energy	-7.0	10.4	10.4	-22.4	-5.3	11.3	11.0
Materials	17.2	17.2	17.4	-15.2	-33.3	13.8	12.2
Industrials	13.8	13.8	14.6	-16.9	-17.4	15.5	14.2
Consumer Discr.	19.0	10.4	13.5	-10.1	-31.2	15.8	15.3
Consumer Staples	5.2	9.1	9.3	-36.0	-52.9	17.1	15.8
Health Care	0.5	8.2	8.2	-5.6	-31.0	16.5	14.4
Financials	14.8	10.1	10.5	2.1	-17.3	12.0	11.3
IT	9.5	12.5	12.8	-8.3	23.1	14.7	16.0
Telecom Services	-3.5	5.7	5.9	-21.3	-38.5	14.7	14.4
Utilities	20.9	7.6	10.9	-10.2	-15.4	13.8	13.7
AC World	6.5	10.7	11.4	-12.8	-17.9	14.1	13.2

Earnings and valuation data of sectors (MSCI AC World). The earnings revisions index is calculated by using the difference between the number of up- and downward revisions relative to the number of total revisions.

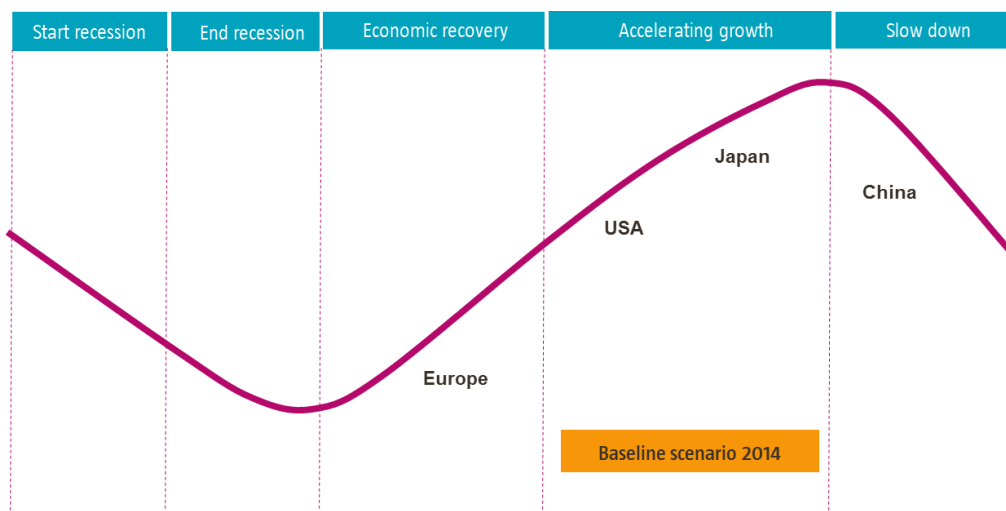
Source: Thomson Reuters Datastream. Robeco

Position in the economic cycle

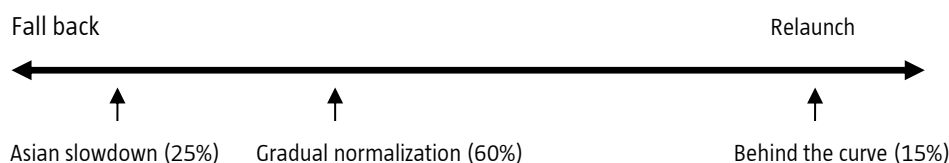
Macroeconomic scenarios and Robeco's view versus consensus

The world economy is developing positively, led by the US. Our baseline scenario foresees a further gradual recovery. 'Abenomics' is still on track, thanks to energetic action by the Japanese central bank. The Chinese authorities will prevent an excessive cooling of their economy and are in no hurry to implement ambitious reforms. The Eurozone continues to show gradual improvement. Our alternative, pessimistic scenario foresees a weaker global economy caused by slowing growth in Asia. In a positive scenario, the world economy is showing surprising strength, but central banks are unwilling to act correspondingly. As a result, inflationary risks will increase.

Position in the economic cycle – Europe lags the other major economies



Macroeconomic scenarios: a gradual normalization is the most likely outcome



Source: Robeco

Robeco's expectations for growth are higher than consensus for the US, Eurozone and UK

GDP growth by region (%)	2013	2014	2015	Δ-1m 2014	Robeco*
US	1.9	2.8	3.0	0.2	=
Eurozone	-0.4	1.0	1.4	0.0	+
UK	1.7	2.6	2.4	0.2	+
Japan	1.7	1.7	1.2	0.1	=
China	7.7	7.5	7.4	0.0	-
India	4.6	4.7	5.4	-0.1	=
Brazil	2.3	2.2	2.3	-0.1	-
Russia	1.5	2.2	2.6	-0.2	=

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

Source: Consensus Economics, Robeco

Robeco's expectations for inflation are higher than consensus for the US

CPI by region (%)	2013	2014	2015	Δ-1m 2014	Robeco*
US	1.5	1.6	1.9	-0.1	+
Eurozone	1.3	1.1	1.4	-0.1	=
UK	3.1	2.9	3.0	-0.1	=
Japan	0.3	2.3	1.6	-0.1	=
China	2.6	3.1	3.3	0.0	-
India	9.5	9.8	8.0	0.7	-
Brazil	5.9	5.9	5.6	0.1	=
Russia	6.5	5.3	5.1	-0.2	=

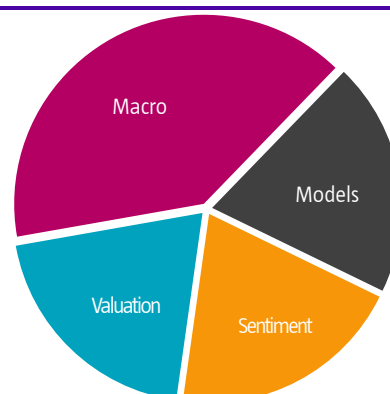
* indicates whether we expect a higher (+), matching (=) or lower (-) growth rate than the current consensus estimate for 2013

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.

Input factors for our investment policy



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 if investors put too much weight on recent developments. Finally, we use quantitative models to steer our expectations.

The table below shows our current multi-asset allocation table. We recently switched funds from emerging markets debt into equities by reducing our allocation to bonds by 1% and used the money to raise our exposure to stocks by 1%.

	Portfolio	BM	active	previous	tracking error	risk budget
Equities Developed Markets	27.5%	25.0%	2.5%	2.5%	0.38%	45.2%
Equities Emerging Markets	6.0%	5.0%	1.0%		0.18%	19.7%
Real Estate Equities	4.0%	5.0%	-1.0%	-1.0%	0.16%	-16.0%
Commodities	5.0%	5.0%			0.00%	0.0%
Core Gov Bonds 1-10	14.0%	20.0%	-6.0%	-6.0%	0.17%	12.2%
Core Gov Bonds 10+	7.5%	7.5%			0.00%	0.0%
Investment Grade Corp Bonds	20.0%	20.0%			0.00%	0.0%
High Yield Corp Bonds	10.0%	5.0%	5.0%	5.0%	0.29%	29.0%
Emerging Market Bonds LC	4.0%	5.0%	-1.0%		0.08%	-4.2%
Cash	2.0%	2.5%	-0.5%	-0.5%	0.00%	0.0%
EUR/USD	-4.0%	0.0%	-4.0%	-4.0%	0.34%	-5.2%
EUR/JPY	2.0%	0.0%	2.0%	2.0%	0.26%	19.2%
EUR/GBP	0.0%	0.0%			0.00%	0.0%
EUR CASH	2.0%	0.0%	2.0%	2.0%		
Portfolio risk	6.65%	6.08%				
Sum of individual tracking errors	1.87%					
Portfolio tracking error	0.73%					

Closing date for text: 07 February 2014.

We refer to calendar months in all our data tables.

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