Happy new … investment strategy!

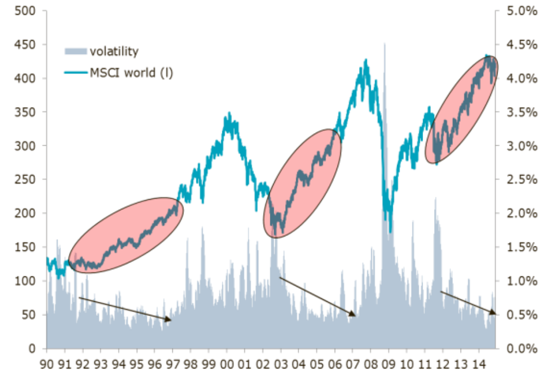
- Risk is taken off the table as the new year ushers in volatility
- Many factors cause slump, from Grexit threat to oil price collapse
- Macroeconomic outlook: QE likely in the Eurozone, 'Grexit' unlikely
- Asset allocation: Overweight in equities is reduced to neutral

Topic of the month: Time to reconsider positioning

Those who had hoped to enjoy a couple of slow days at the start of the year have been disappointed. Three trading days into 2015 and all of the major stock markets are into the red, bond yields have dropped to new all-time lows (with the exception of the US), and the oil price has plummeted below USD 50 per barrel. For the third time in four months there is a sense of panic in the more risky parts of the financial markets, with European stocks dropping by more than 3.5% in a single trading day. Greece and oil seem to be the culprits behind the sell-off, but actually for there have been several issues simmering below the surface for some time. The growth slowdown in China, weaker European economic growth prospects, pricy equities, Russia, and the fear of deflation are all weighing on sentiment.

So far, Robeco Asset Allocation has been willing to bear the volatility. In both previous sell-offs (October and December) we stuck to our overweight positions in equities and high yield. However, we are currently less inclined to do so and have decided to lower the risk profile of our portfolio. The reasons to do so now are as follows:

Getting to the more difficult part of the stock market rally



Source: Bloomberg, Robeco

A more volatile year

The first observation is that we expect 2015 to be a more volatile trading year, with the easier part of the stock markets' rally now behind us. As can be seen from the chart below, the first part of the recovery in stocks is normally one that is characterized by declining levels in volatility. The second phase, which we think we have currently entered, is the phase in which stocks still go higher, but will do so with a higher level of volatility. The period of cheap valuations has passed and gains in stocks will be more linked to the underlying fundamentals. This is particularly true for the US, where the Fed has ended its QE expansion program and markets are generally anticipating the first rate hike later this year.

Volatility in itself does not need to be bad, so long as the general direction of stocks remains up. With liquidity still ample and increasingly fewer return-yielding investment alternatives available, we continue to expect stocks to trend higher. This more volatile trading environment means that we are no longer comfortable with being overweight all of the time, like we were during 2013.

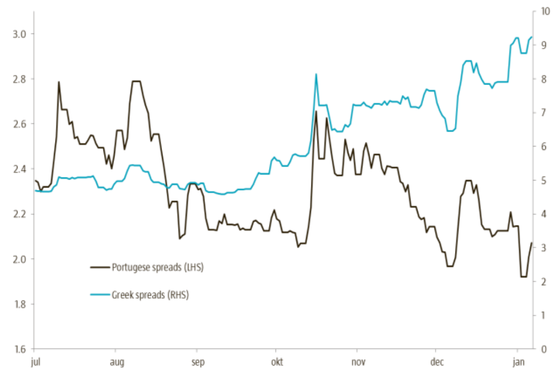
Greece has flared up again

The failure to elect a new President at the end of last year means that new Greek parliamentary elections will take place at the end of January. This has revived the concept of Greece leaving the euro (the so-called 'Grexit') as a potential risk. The most important point to note is that there are stark differences compared to the last time that Grexit fears roamed the markets. Then, a Grexit was synonymous with the end of the euro, as it would have caused subsequent dominoes (Portugal, Ireland, Spain and eventually even Italy) to fall. This time around, whereas the spread on Greek bonds has risen sharply in recent months, spreads on, for example, Portuguese bonds have on balance declined.

This can be seen as good news: contagion is no longer the big driver these days. Most Greek government debt is in the hand of official institutions (the ECB, EFSF and IMF), with only a very limited exposure to the European financial sector. However, this changes the balance of power between Greece and the rest of the Eurozone, raising the odds of an actual Grexit. Whereas a Grexit was unthinkable back in 2012, it is now a serious option. This also explains the pretty harsh stance taken by German Chancellor Angela Merkel, who indicated over the weekend that she was comfortable with Greece leaving the euro. This could imply that (bond) markets so far have been too complacent on the matter. Additionally, whereas we are not looking at financial contagion this time around, there could be political contagion, as there are elections in Spain and Portugal later this year.

Much depends on the outcome of these elections. So far, the ultra-left Syriza has taken the lead in the polls, even though the most recent numbers seem to suggest that the liberal-conservative New Democracy has managed to narrow the gap somewhat. Syriza's aim is not to leave the euro, but to renegotiate the terms of the bailout deal with Europe and bring an end to austerity. Given the current stance of Merkel, this can be considered a collision course. Although we do not expect that this will actually lead to a Grexit – although we certainly cannot exclude it either – we prefer to take our chips off the table to see how this process develops.

No contagion in European bond markets



Source: Bloomberg, Robeco

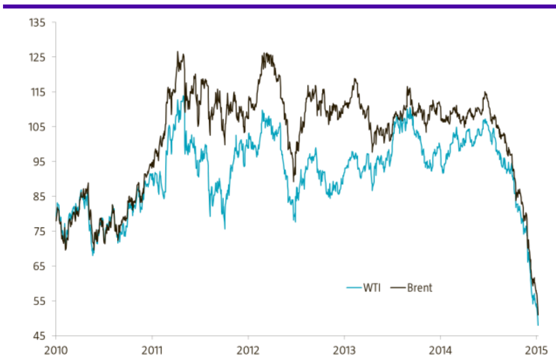
Oil price plummets

There is simply more supply than demand - that's the short answer to why the oil price has collapsed by more than 50% over the last six months. If we want to add some more color, we could talk about the shale gas revolution, Middle East oil production coming back on line, weak European and Chinese growth, and the decision by OPEC (or the Saudis) to refrain from cutting production. The outcome is still the same: the oil price has tumbled and this has unsettled markets. There are three reasons why a decline in the oil price could be considered bad news for markets. The first is that this in itself is an indication of even more weakness in world demand. In this line of thinking, oil is a proxy for the strength of the world economy, which is clearly pointing lower. Although this is certainly not a failsafe conclusion (there is the demand side to consider as well), it has partly been corroborated with weaker PMI data from the US and China recently.

The second and probably more important reason is the uncertainty about the health of the oil-producing companies. The impact has been most direct in the US High Yield market, where the oil sector comprises a substantial 17% of the total index. Spreads have widened to over 1,000 basis points, from the 350 basis points low seen in June, which dragged spreads higher for the market as a whole. This has been the reason that we switched from High Yield to stocks in the fourth quarter of last year. The third reason is the disinflationary impact of a plummeting oil price, which currently adds to deflation fears in Europe. Although this in itself should not be a decisive factor (the drop in oil is 'good' disinflation), it certainly plays a role in extending the rally in bond markets worldwide.

So far we have only highlighted the negative side of cheaper oil, but there is certainly a positive side as well. Consumers will reap the benefits of lower gasoline and heating costs, as will many manufacturing sectors which will see their margins improve. Growth will certainly be boosted by these lower oil prices, especially if this decline is going to stick. It should be mentioned however that it takes time for the growth impact to materialize, with the brunt of the growth increase kicking in only after one year after the price decline. As such, the uncertainty over the state of the world economy and the prospects of oil-producing companies can dominate in the short run, after which the positive growth impact starts to kick in.

The drop in the oil price continues

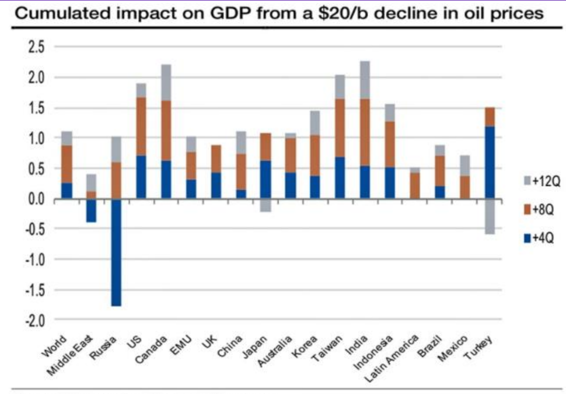


Source: Bloomberg, Robeco

Rebalancing our multi-asset portfolio

All in all, the decision to lower our risk profile is not a based on one risk factor, but rather a multitude of factors. Overall we are still not negative on stocks, but we think it is prudent to adjust the buy-and-hold approach that has served us well to a more flexible investment approach. By sticking to our overweight position through past sell-offs, we limited the scope to take advantage of the buying opportunities that it created. On balance, we remain slightly overweight to risk via our position in High Yield, but we have reduced our overweight position in equities to neutral. Additionally, with disinflation likely to be the dominant theme for another couple of months, we have also reduced our underweight in real estate to neutral. Even though we think bonds offer limited upside at these levels, it is hard to see where the sell-off will come from in the short run, which means that there is no direct reason to expect real estate to start underperforming.

Growth impact of the falling oil price is positive



Source: SG Cross Asset Research/Economics

Macroeconomic outlook: QE likely, 'Grexit' unlikely

The most important development for the world economy in recent months has been the collapse in the price of oil as a consequence of the ongoing shale revolution in the United States, and increased production in Canada, Iraq and some other countries. The oil price has further fallen due to attempts by Saudi Arabia and other Gulf producers to protect their market share instead of cutting back production, and through weak demand from China and the Eurozone. The market has not achieved a new equilibrium, which can easily take several months to achieve. Generally, a collapse in oil prices is considered to be a boon for the world economy, as consumers benefit due to the rise in real incomes. The adjustment of the world economy to lower prices is of course not cost-free, but in general, the developed countries will benefit.

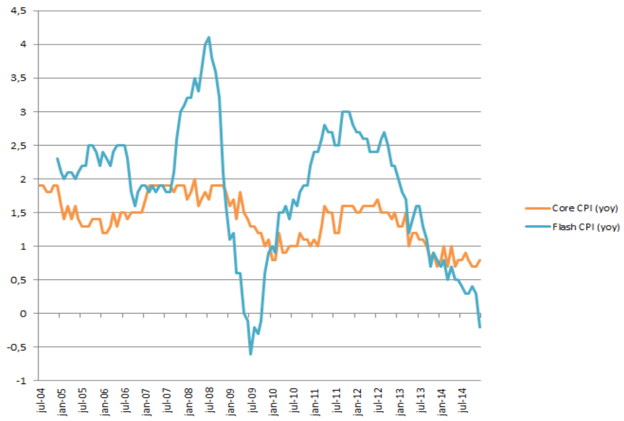
Eurozone: Oil boost but risks over Greece and Russia

The Eurozone generally benefits from oil price developments, while Greece and Russia remain large risks. The collapse in oil prices pushed headline inflation in December into negative territory. The mild deflation is putting pressure on the European Central Bank (ECB) to engage in Quantitative Easing (QE) as early as 22 January (even though this is three days before Greek elections). Though it has been resisted by a minority of countries led by Germany, some sort of QE is in our opinion inevitable (possibly limited in size and/or with restrictions on the level of creditworthiness), with the ECB clearly missing its "below but close to 2.0%" target and the firm commitment by ECB president Mario Draghi to "do whatever it takes to save the euro". Some face-saving compromise for German policy makers will probably be found. The euro has weakened substantially in anticipation of QE and will support the European recovery.

The main risks to this scenario, which would enable a growth rate of around 1.5% in 2015, are an escalation of the tensions with Russia and/or a flaring up of the European debt crisis, for example as a consequence of Greece sliding towards an EMU-exit ('Grexit'). Tensions with Russia have in the course of 2014 particularly damaged German producer confidence and led to lower investments, which is unusual during a recovery. The situation in Ukraine seems to have stabilized at the moment and a further easing accompanied by a lifting of (some of) the imposed sanctions (as recently hinted upon by French President François Hollande) is a possibility after successful negotiations in the Kazakhstan capital Astana scheduled for 15 January . On the other hand, earlier negotiations in the Belarus capital Minsk led nowhere and the Russian economy is drifting into a severe recession, mainly due to the collapse in oil prices. This could easily lead to more adventurism by Russian President Vladimir Putin. The situation remains dangerous and unpredictable.

The other risk is a Greek slide-out of EMU, for example after an election victory on Sunday 25 January by the Greek ultra-left party Syriza. Polls suggest a tight race between Syriza and the liberal-conservative New Democracy to become the largest party in the Greek parliament. The largest party will get an additional 50 seats bonus. This will probably still be insufficient for either party to gain an absolute majority. If New Democracy becomes the largest party, the status quo before the elections will probably continue, including ongoing difficult negotiations with the 'troika'. If Syriza becomes the largest it probably also will need a coalition partner. At least four small parties are likely to win more than 3% of the vote and enter parliament, but only the PanHellenic Socialist Movement (Pasok) and a new centre-left party To Potami (The River) look like possible partners. Negotiations will be difficult. Moreover, the two-month extension to Greece's bail-out expires at the end of February, increasing the pressure to form a government fast. Syriza wants to renegotiate the terms of the bailout deal with Europe and bring an end to austerity. It is unlikely to succeed at this, and could in a worst case scenario end up defaulting on Greece's debts and getting cut out of the Eurozone.

Eurozone headline CPI versus core CPI



Source: Datastream, Robeco

We do not consider this scenario very likely because likely necessary coalition partners are unlikely to concur, Syriza has recently toned down its rhetoric, and 74.2% of Greeks answered "yes" or "probably yes" on whether Greece should stay in the Eurozone "at all costs." A 'Grexit' would be highly unpopular with voters and would raise the specter of a failed state on NATO's southern flank, which is geopolitically very unattractive in the light of Turkey's increasing unpredictability and Russia's aggressiveness. A 'Grexit' wouldn't be a systemic risk for the Eurozone due to the backstops which have been created and the fact that most Greek government debt is in the hands of official institutions such as the ECB, EFSF and IMF. The lack of serious contagion so far to other peripheral bond markets can probably be explained by this fact. The direct economic impact would be limited. If a 'Grexit' did lead to a significant recovery of the Greek economy in the years to come, thanks to the effects of a significant competitive devaluation of the new drachma (a not very likely scenario given Greece's weak institutions, so it is a very large 'if'), it could destabilize the Eurozone, putting Portexit, Itexit, Spexit or even Frexit on the agenda.

China: Slowdown will provoke more stimulus

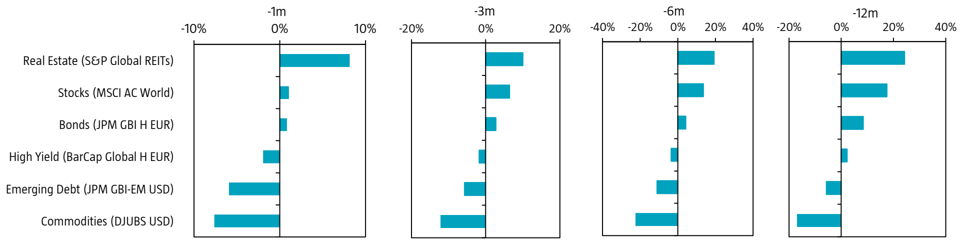
The severity of the collapse in the oil price has led to some doubts about the trustworthiness of Chinese statistics. Could it be that growth (amounting to a suspicious 7.3% growth rate year-on-year in Q3 2014) has been overstated? In any case, Chinese authorities have recently stepped up their stimulus measures for the Chinese economy, even officially lowering interest rates. Additional stimulus, including a further cut in interest rates and further slippage of the yuan vis-à-vis the US dollar is to be expected, as the Chinese authorities will strive to keep growth at around 7.0% (from 7.5% for 2014), the most likely target for 2015 to be announced in the Spring. Stimulus will be facilitated by benign inflationary developments. China is, of course, a beneficiary of the collapse in oil prices as it is a net importer.

US: Confidence indicators weaken

The US economy did unexpectedly well in the third quarter, showing GDP growth of 5.0% on a yearly basis. The Fed has explicitly signaled a possible first rate hike in April. Given the deflationary impact of the collapse in oil prices (pushing down headline deflations) and the strengthening of the USD and the recent weakening of forward-looking indicators, a first hike is more likely at a later stage in 2015 (probably Q3). We would have to see significant wage growth and a further reduction in the unemployment rate. It could be argued that a US economy heading for 3%-plus growth in 2015 is ready for the start of policy to take 'the punch bowl away'. A first step would be a modest 25 basis points. It cannot be expected that the Fed has a clear view on the likely impact of its first hike. It will proceed cautiously.

Asset allocation: Time to reconsider positioning

Performance of asset classes (gross total return in euro) – real estate place outpaced other risky assets again



Source: Thomson Reuters Datastream, Bloomberg, Robeco

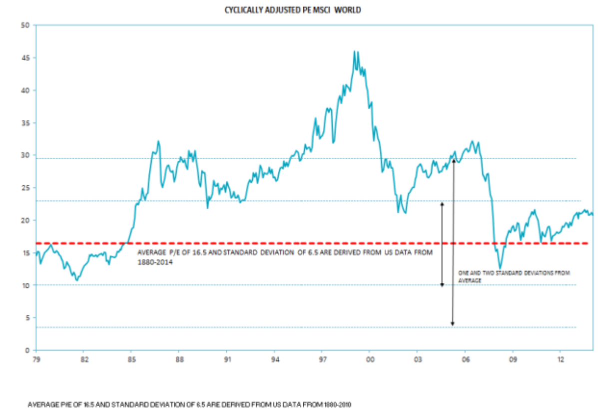
Oil and Greece warrant less aggressive risk profile in equities

We are now neutral on equities. The year ended on a high note for global stocks with the Dow Jones climbing above 18,000. Nevertheless, December, a traditionally strong month for equities, brought some unexpected volatility as new sources of uncertainty emerged. With OPEC clearly indicating it planned to refrain from its assumed role of swing producer, the oil market is now left to itself to rebalance supply and demand. This new dynamic in the oil market brought accompanying uncertainty which seemed to spill over into the equity market last month. Concerns about underlying demand deficiency as a driver of lower oil prices and its disinflationary impact weighed more heavily on the markets. The cancellation of capital spending plans by the energy sector also played a role. Not only did the oil market stir volatility, but also the inability of Greek lawmakers to re-elect a new president led to a re-emergence of 'Grexit' fears after two years of absence. Volatility in the European stock market edged up as anti-euro party Syriza leads the polls up to the general election on 25 January and Eurozone headline inflation turns into negative territory. Given the recent disinflationary trend, QE has been almost fully priced in by the markets. However, we think the ECB will likely embark on a compromised version given German resistance to 'Fed-style' QE. If further easing is announced at all in the next ECB meeting, a less effective quantitative easing program is likely to emerge. Thus, with several factors that could cause equity market sentiment to deteriorate, we prefer neutral equity weightings.

The fundamental picture also points suggests a more neutral stance on equity risk in the near term. Earnings revisions have been negative in recent months for major equity regions except Japan, where exporters are still profiting from the weak yen. Although multiple expansion has slowed down, equities are not cheap, with valuations around 20% above the MSCI World's historical average. Momentum for most regions has weakened as well. From the macroeconomic perspective, tailwinds likely remain as additional easing by central banks in the Eurozone and Japan will mitigate the tightening impact of the Fed, which is preparing the markets for a policy rate hike, probably in Q3 this

year. Subdued capital market rates are beneficial for sustaining current valuation levels.
One of the equity market themes that we envisage for 2015 is an increased focus on underlying fundamentals. Multiple expansion has led the rally in recent years, but with valuations now elevated, the window of opportunity has shrunk. Earnings growth remains key as the Fed hints about raising its policy rate later in 2015. In the US, earnings growth is expected to remain healthy despite dollar strength as overseas earnings are partly hedged. Profit margins will remain resilient in the near term in an environment of mediocre wage growth and capital market rates that are under pressure due to safe haven flows into sovereign bonds. We expect an increasing contribution of sales growth as consumer spending is boosted by exceptionally low gasoline prices, especially in the US.

With higher volatility around, multiple expansion takes a pause



Source: Datastream, Robeco

Looking further ahead, we remain constructive on equities from the fundamental perspective as well as from a cross-asset perspective. Historically, the first stages of a Fed hiking cycle typically coincide with above-trend earnings as rate hikes confirm strong macroeconomic momentum. Unlike other risky assets, equity risk premiums are still above long-term averages, suggesting there are few alternatives for equities around.

High yield shows some cracks, but remains attractive

We remain overweight in high yield. Yields are still at attractive at levels of 6.7% and January is traditionally a strong month for the high yield market. Also, the European high yield market is quite shielded from the downside impact of lower oil prices, especially with some form of QE by the ECB around the corner. Therefore, investors may have overestimated the concerns about the oil impact for the wider high yield market.

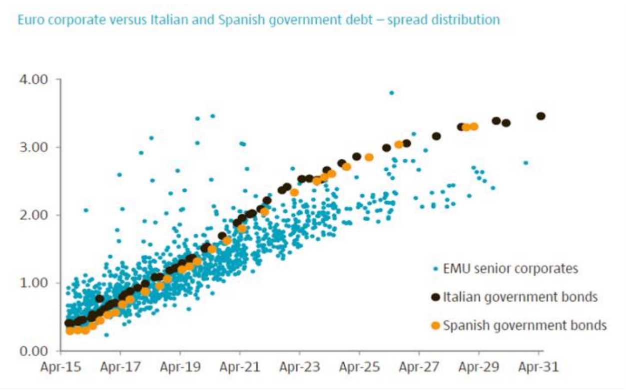
Nevertheless, last month’s performance was underwhelming, with a negative return of -1.9%, behind other risky assets such as stocks and real estate. The oil rout in the energy industry has caused some cracks to appear in the high yield market. Issuance in 2014 has been less exuberant compared to previous years as firms have to pay higher coupons, starting in the (US)oil sector. Credit spreads in the US high yield energy sector have widened above 10% as defaults in the US oil sector are expected given that the oil price has steepened its decline in recent months. Some defaults seem inevitable, also as OPEC strategically aims for production fallout from the US shale oil sector. Financial market stress has been elevated due to developments in Greece and oil, which coincided with spread widening in the global high yield market.

However, although defaults could rise in the medium term, the current environment of subdued growth and low inflation remains benign for the asset class. European high yield has a better average credit rating than its US counterparts and a lower issuer share from the energy sector. With the ECB now pushed to further easing as disinflation intensifies, we think high yield is relatively well positioned within the risky asset spectrum to benefit from further (credit) easing in the Eurozone. From a global perspective, the search for yield will continue, albeit at a more measured pace as the uncertainty about the timing of the first Fed hike gradually will come to the forefront of the debate in the course of 2015. Although risk perception is elevated, we think investors are still willing to pay a relatively high price for additional carry. Coupons are still relatively attractive, especially after the spread widening we have seen. But the spillover danger from the US energy sector to the other high yield sectors cannot be excluded completely, and therefore we remain vigilant in the medium term.

Investment grade credits have lost allure

We maintain the view that, when corrected for risk, high yield remains more attractive than the ultra-low rates that investment grade credits offer. Investment grade performed better than its non- investment grade counterpart in the recent episode of market volatility. But as many yields in the euro investment grade credit market are below those of a global government bond index, neither the yields nor the spreads are looking relatively attractive to us. The spread component for the average investment grade corporate is priced for perfection, although typically the better-rated companies have seen the largest spread compression. Downside risk in the course of 2015 has become more substantial as the ECB has hit the zero lower-bound level and the bond market has moved accordingly to ultra-low rate levels. Any reacceleration in the macroeconomic momentum or a pick-up in inflation in the Eurozone could lead to higher sovereign bonds rates, which will correspondingly lead to lower price returns on investment grade bonds. In the near term the picture for investment grade could be less bleak, with some form of QE by the ECB coming months providing support for investment grade yields. We remain underweight credits.

IG spreads are often below those of corresponding sovereigns

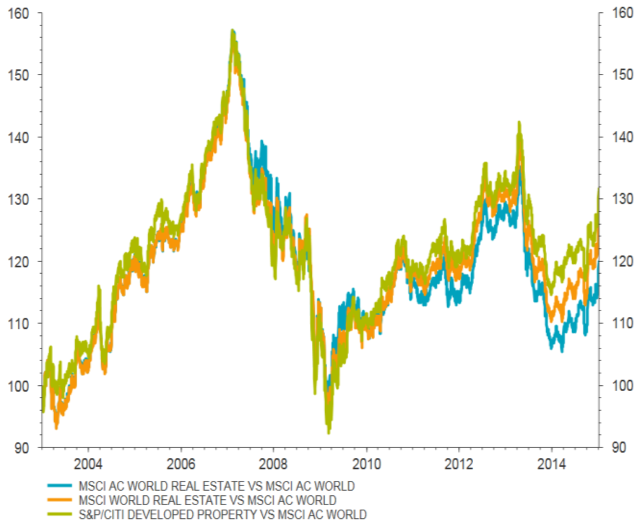


Source: Bloomberg, Robeco

Real estate remained a strong performer

We are now neutral on real estate compared to equities. Real estate remained resilient during the recent market turmoil, posting a very decent monthly return of 8.2%, and it was the best performing asset class of 2014. The pronounced decline in bond yields was also helpful in fuelling real estate returns. The disinflation due to lower oil prices and increased safe haven flows due to re-emerging 'Grexit ' fears caused government bonds to rally along with real estate. The asset class's correlation with fixed income has increased over the years, making real estate more or less a substitute for sovereign bonds. Also, the dividend yield is either comparable to, or often exceeds, yields on government bonds. With economic growth expected to strengthen, rising rents and dividends will make real estate less sensitive to higher bond yields.

Real estate has outperformed the MSCI AC World Index



Source: Datastream, Robeco

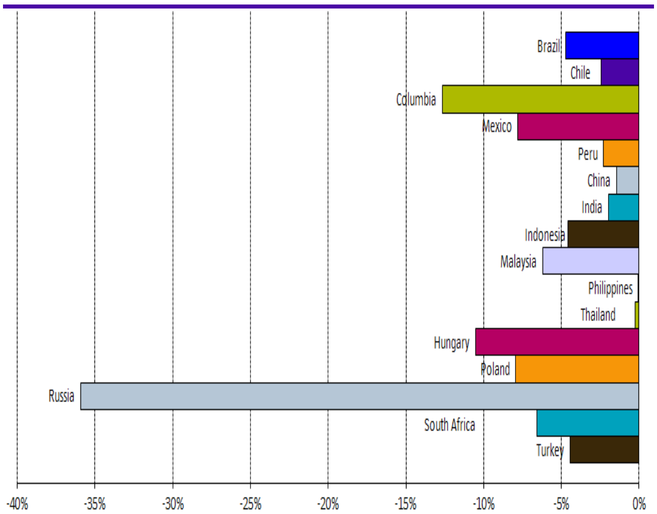
Despite our view that sovereign bond yields could stay low for somewhat longer given current (powerful) yield-compressing factors at play, we stay neutral on real estate. The sector is not in the last place, because we expect yields to bottom out somewhere in 2015, but we are also (still) not positive on the relative valuations of real estate compared to equities. The current forward earnings multiple is 28.7 compared to 15.0 for the MSCI World Index.

Emerging market debt has tempting yields, but elevated currency risk

We remain neutral on emerging market debt (EMD). In local currency terms, the asset class returned -5.9% last month. The risks of an uneven recovery in emerging markets remains as the recent drop in oil prices has created different policy room implications for different EMD issuers. We see fewer signs of a pickup in activity in emerging debt-issuing countries as the weighted average producer manufacturing index signals a slowing expansion. While leading activity indicators in the broader emerging market shows increasing expansion (HSBC EM PMI at 51.7), the PMI of the largest 10 emerging market issuers has declined from 51.1 to 50.6.

The spread of EMD local currency has trailed the deceleration of the EMD-issuing countries leading indicators. But from a currency risk perspective, local currency debt faces upside risk. Currency risk remains on the forefront of EMD return movements as oil-exporting countries face downside pressure as the oil market is still in the process of rebalancing excess supply with lower demand. Political risk, one of the major factors behind spread movements, has not vanished. The Ukrainian-Russian conflict is negatively impacting economic performance in Hungary and Poland, both of which are EMD issuers. Both countries are now experiencing deflation. Russia has experienced large capital outflows and this has led to a surge in ruble volatility. The central bank has raised the policy rate to 17%, but this has only prevented worse. The ruble slid 62% against the dollar in 2014. With sanctions appearing to bite and the decline in the price of its major export product, oil, the market will continue to test the willingness and ability of the central bank to employ currency reserves.

Massive slide of ruble against dollar



Source: Bloomberg, Robeco

Meanwhile, Brazil isn't experiencing a smooth ride after a rating downgrade last year, and President Dilma Rousseff made promises for reforms after her re-election but has thus far not delivered them. Her economic reform program lacks punch. This does not bode well for the much-needed supply side reforms as her previous successes on reforms have proven to be limited. Fiscal dynamics in oil-exporting countries are expected to deteriorate as oil revenues decline.

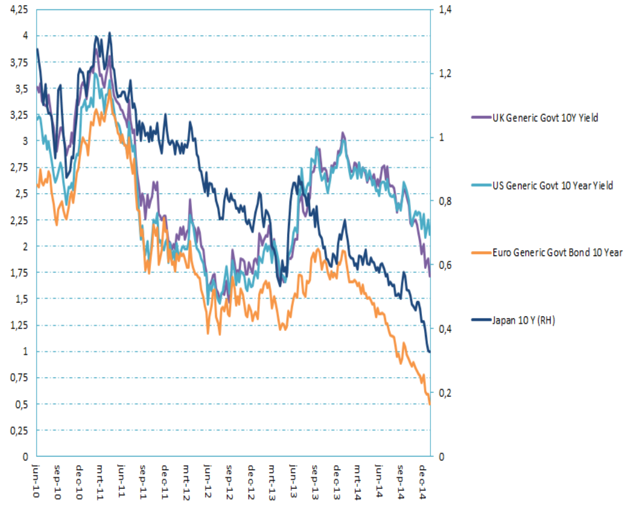
We are not positive on the currency developments. Momentum for emerging market currencies remains negative. On the other hand, lower oil prices could help lower inflation in net oil-importing emerging countries and improve current accounts. Monetary policy room has improved in oil-importing debt issuers like Turkey and Poland while policy room is getting more restrained in countries like Mexico. From the other side of the exchange rate cross, the strong performance of the US dollar has also not been beneficial for EMD performance in local currency terms. The positive for emerging market currencies is that the correlation with the trade-weighted dollar is declining. However, this correlation could increase again as the US economy keeps on track, despite faltering growth elsewhere, supporting the dollar. Higher volatility in the US Treasury market, which could stem from the increasing cyclical strength in the US, could bring more volatility in emerging market currencies as well.

The current EMD yield of 6.46% stands in sharp contrast to the subdued yields of sovereign bonds in developed markets, keeping EMD in local currency terms relatively attractive, despite the currency volatility. There are still reasons to remain selective and to err on the side of caution, although disinflation could give central banks some leeway to lower interest rates to stimulate economic activity. We expect continuing divergence within emerging markets according to differences in export orientation, current account balances, fiscal and monetary policies, and political stability. We are not outrightly defensive as EMD yields are close around those of high yield, even after the spread widening we have seen in the latter asset class.

We are less pessimistic on government bonds' prospects

We remain negative on high-quality sovereign bonds as we expect nominal rates in developed markets to rise in the course of 2015. However, we are less pessimistic about the near-term prospects for developed markets government bonds as disinflation intensifies with the steepening decline in oil prices. We now expect the ECB to embark on some form of QE at its next meeting on 22 January. An eventual QE program will be limited in size and composition as Germany still opposes 'Fed style' sovereign bond purchases. A compromise between the ECB and Germany will likely result in some additional form of credit easing. In the past quarter, German bond yields declined to 0.48% in anticipation on ECB action and the rally was also instigated by safe haven flows as the Greek debt sustainability issue is back on the European agenda.

German 10-year bond yields are now below 0.5%



Source: Bloomberg, Robeco

However, as time progresses, these yields seem increasingly unsustainable from a valuation perspective. Leading activity indicators confirmed that the Eurozone economy remained in expansionary territory, with the composite PMI at 51.4. In the US, strong inflows due to the strong dollar, safe haven seeking behavior and lower yields elsewhere have suppressed Treasury yields. The progress in the labor market has been consistent, with unemployment now at 5.8%. The slack in the labor market is gradually diminishing and this has turned the Fed more hawkish. However, the dropping of the phrase in the FOMC minutes that rates will remain low for a "considerable time" implies that there is unlikely to be any Fed action before summer. A rate hike in Q3 is more likely as the dilemma for the Fed increases due to the ongoing disinflation caused by the strong US dollar.

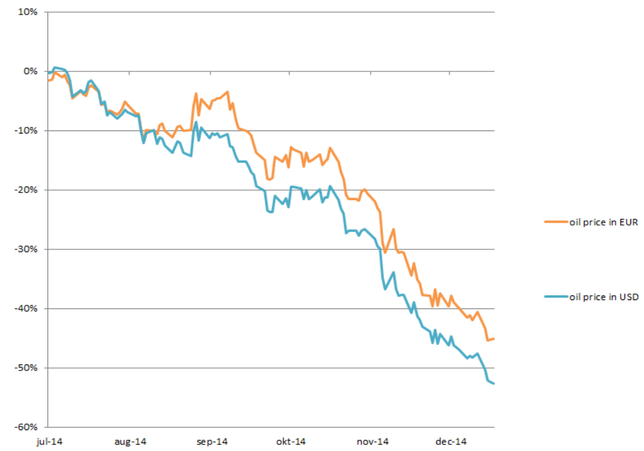
In the Eurozone, the rate market is showing negative real yields, suggesting that the market is fully pricing in secular stagnation in the bloc. However, we expect the Eurozone to gradually normalize to pre-crisis growth levels (1.5% real growth in 2015), but it will take consistent and significant upward growth surprises to turn the market gradually away from the secular stagnation theme. An impetus, both from the economic and a monetary side is needed, and we see positive developments on both sides. The ECB's balance sheet expansion will validate the recent depreciation of the euro versus the dollar, regaining (German) export strength as China keeps its growth rate around 7%. But the ECB needs to act decisively as it is in increasing competition with the Bank of Japan (BoJ), which also has reset its balance sheet targets. As a net oil importer, the euro area will experience a real growth boost later in 2015 as a result of the exceptional decline in oil prices.

High yield bonds have better relative risk/return profiles. We therefore prefer non-investment grade corporate bonds to government bonds as high yield provides a decent spread buffer, especially after the spread widening in high yield market we have seen.

Unbalanced oil market in free fall

Commodity prices have continued to fall along with US dollar strength since August. Contrary to expectations , OPEC did refrain from cutting production levels in late November, and this has given the oil market a totally new dynamic. With the Saudis no longer acting as the swing producer, the market has to rebalance itself by price. This rebalancing process is complicated as both supply and demand sides are moving in opposite directions. Excess oil supply has even increased since November as Russia has stepped up its production as well as Iraq. Inventories in the US have also risen and the export of US oil seems to be entering a new chapter as well. The oil market is being further affected by faltering demand as global growth momentum has slowed. A key element in finding the bottom for the oil price are developments in the US oil sector. Thus far, the US energy sector has not shown net job layoffs, with none in December, but signs of this in coming months could indicate that US oil producers are cutting back on production. However, hedging demand among US producers has surged, and this could prolong the slump in oil prices as oil revenues remain high enough for them to remain in business. In the meantime , the Saudis have few incentives for an emergency meeting as the country's foreign reserves are ample enough to withstand an even further decline in oil prices.

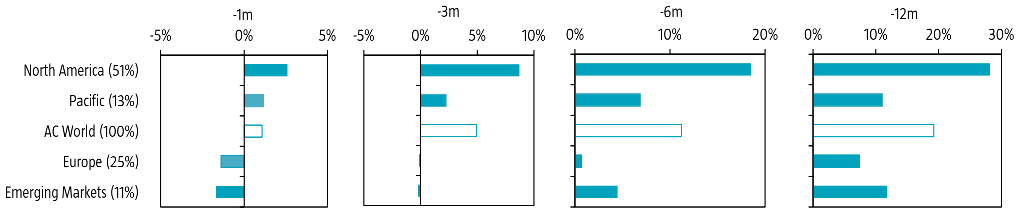
Unbalanced oil market in free fall since 2014 (y-o-y %)



Source: Bloomberg, Robeco

Regional asset allocation: Preference for Asia Pacific

Positive momentum for Asia Pacific and US



MSCI AC World unhedged EUR; index weights between brackets

Source: Thomson Reuters Datastream, Robeco

Asia Pacific: Japan remains firmly in the easy money mode

We are overweight on Asia Pacific, especially in Japan, predominantly because the Bank of Japan will remain in easing mode for a considerable time. The BoJ will expand its balance sheet aggressively by an additional 50 trillion yen per annum, buying up Japanese government bonds amounting to 16 % of GDP. The slowing in economic activity has brought forward action by the central bank to weaken the yen further and stimulate the export-dependent economy. A stronger dollar will also help further yen weakening. Japanese earnings revisions have remained positive and will get an additional boost from the very recent yen weakening, which bodes well for future equity returns. Also the so far unsuccessful efforts of premier Abe to encourage corporates to raise nominal wages will solidify profit margins in the near term. Equity valuations for Asia Pacific are still comfortably below their 10-year averages.

Earnings revisions are negative for global equities

	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	*FY2*	*12m*	*3m*	*1m*	*Current*	*10y avg.*
North America	5.8	7.4	7.7	-18.8	-30.8	16.7	14.0
Europe	2.9	9.3	9.0	-26.1	-24.7	14.2	11.8
Pacific	8.5	8.6	8.9	4.4	23.6	14.3	14.9
Emerging Markets	0.6	11.2	11.3	-26.6	-31.4	10.9	10.9
AC World	4.7	8.5	8.6	-20.1	-21.2	15.0	13.1

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

Europe: Volatility has returned while earnings revisions remain negative

We are neutral on European stocks. Momentum has remained negative and European stocks have experienced higher volatility this month compared to other regions as fears of a 'Grexit' mounted again. In the case of "Grexit", elevated systemic risk in the Eurozone will require higher equity risk premiums for European stocks, hurting performance. Earnings revisions are still in negative territory, indicating more downgrades compared to upgrades of company earnings. On the positive side, we think that additional unconventional easing measures are likely to be announced at the January ECB meeting. This could reinforce the lower euro and improve earnings per share of European corporates through improved exports. Eurozone competitiveness is improving and the services sector shows sign of optimism. But challenges remain. Although the truce between Ukraine and Russia seems to be holding ,the illegal annexation of Crimea has damaged relationships with Europe. Russia will continue to challenge the current status quo, especially as it is likely to experience a severe recession. The Greek debt sustainability problem has come to the forefront again, although serious contagion to other Eurozone countries is not likely given the amount of Greek debt held by official institutions. From a valuation perspective, European equities are better value compared to US equities.

Emerging markets: We are underweight as the strong dollar weakens relative performance

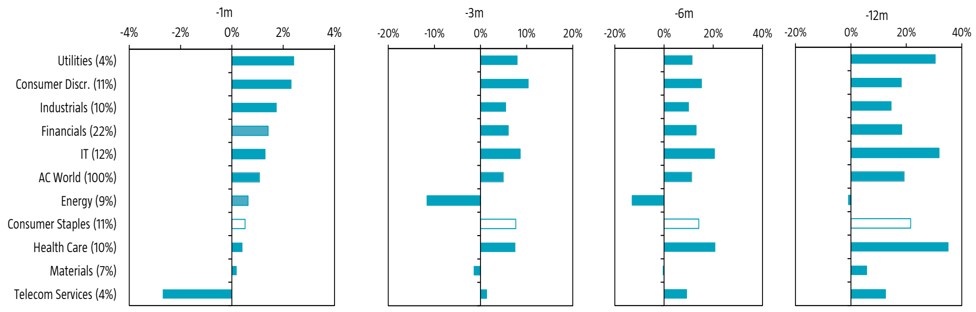
We are underweight emerging market equities. The hawkish tone of the Fed has implications for emerging countries with current account deficits that are vulnerable to the decline in excess global liquidity due to significant dollar funding and/or external portfolio outflows. Also, the stronger dollar has clearly been detrimental for the relative performance of emerging markets equities versus developed markets, and although dollar momentum could slow, its medium-term trend is pointing upwards given the diverging paths in policy by the major central banks. Given our expectation for a continuing strong dollar, we think emerging market currencies will remain under pressure in the near term. From the fundamental side, leading producer indicators are showing that emerging markets are expanding economic activity, but that this expansion is weak and uneven. Developments in Brazil and Russia - both countries experiencing high inflation and weakening currencies - are worrisome as well. With the continuing decline in oil prices, export revenues for commodity-exporting emerging markets are not likely to improve. The deceleration versus developed markets will likely continue with the slump in oil prices. Although there are some bright spots (India), sentiment towards emerging markets remains vulnerable due to the discussion about the direction of Fed policy (end of Fed tapering), geopolitical developments (Ukraine, Russia, Iraq, Hong Kong) and political risk.

North America: US remains resilient but overseas earnings hampered by dollar strength

We are neutral on North America. Momentum is positive and relatively strong for the US stock market. Consumer sentiment is positive as people experience a windfall from lower gasoline prices. Earnings revisions have not reflected consumer optimism , as the strong dollar has a negative impact on overseas earnings of US companies. However, given the strong growth resilience of the US for the slowdown elsewhere in the world, US corporates are facing a relatively benign environment. With the recent decline in Treasury rates, profit margins of US corporates have some additional tailwind, and sluggish wage growth is likely to keep margins elevated in the near term. All in all, we are now more constructive on US earnings; valuations are relatively less attractive but do not indicate some form of irrational exuberance either.

Sector allocation: We are now neutral

Consumer discretionary reflecting consumer optimism in US



MSCI AC World unhedged EUR; index weights between brackets
Source: Thomson Reuters Datastream. Robeco

We are now neutral on sectors. Although we think cyclicals have better cards for outperformance later in 2015, the current risk-off environment is no boon for cyclical performance. With 'Grexit' fears surfacing and an economically wounded Russia also problematic, geopolitical risks are still around. We also expect fewer positive macroeconomic surprises as the US economy has to adjust to the fallout from the oil sector in the near term after a very strong Q3. As we envisage bond yields to stay low for somewhat longer around a moderate bandwidth, we also think the market is not being pushed into cyclicals yet. Instead, growth stocks have lagged in performance compared to value last month. With the disinflationary trend emerging in the US, a Fed rate hike might now happen later rather than sooner, which could harm cyclicals. We find that growth companies' outperformance is positively correlated with a higher probability of a Fed hike at the next meeting.

Cyclical versus defensive sectors – very negative earnings revisions for energy sector

	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	***FY2***	***12m***	***3m***	***1m***	***Current***	***10-yr avg.***
Energy	-0.4	-15.5	-15.6	-60.7	-64.2	13.7	10.8
Materials	0.4	10.3	12.5	-22.3	-19.7	14.0	12.2
Industrials	8.2	13.3	12.8	-11.2	-2.9	15.5	14.1
Consumer Discr.	-1.3	16.0	16.1	-21.0	0.5	15.9	15.2
Consumer Staples	1.9	7.9	8.0	-36.4	-26.4	19.1	15.9
Health Care	11.7	9.8	9.9	9.8	-34.2	17.7	14.3
Financials	5.9	12.8	12.8	-13.8	-15.6	12.3	11.3
IT 12.5	10.6	11.3	-6.4	7.0	16.1	15.4	
Telecom Services	-3.5	6.2	5.1	-11.6	-13.7	15.5	13.3
Utilities	0.8	9.3	8.9	-9.8	-24.3	15.3	13.9
AC World	4.7	8.5	8.6	-20.1	-21.2	15.0	13.1
AC WORLD REITS	-7.4	8.9	8.5	-0.1	-0.4	28.7	N.A.

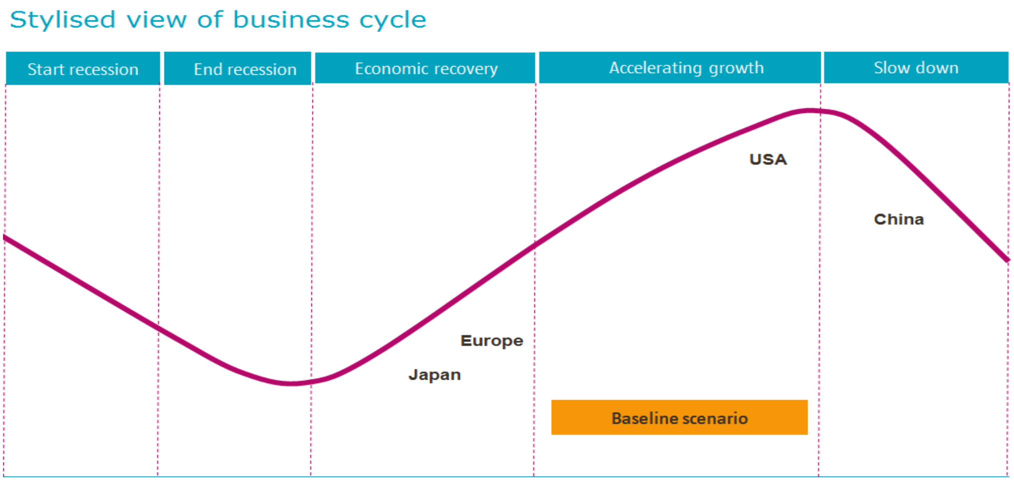
Earnings and valuation data of sectors (MSCI AC World). The earnings revisions index is calculated by using the difference between the number of up- and downward revisions relative to the number of total revisions.
Source: Thomson Reuters Datastream. Robeco

Position in the economic cycle: We continue to foresee a gradual recovery

Macroeconomic scenarios and Robeco's view versus consensus

The world economy is entering a more difficult phase, with the exception of the US, although it is no longer defying gravity after the very strong Q3 2014 GDP growth of 5.0%. Our baseline scenario continues to foresee a further gradual recovery. Japanese Prime Minister Shinzo Abe has a new chance to deliver on Abenomics. The central bank will continue its reflationary efforts. The Chinese authorities will implement additional stimulus. The Eurozone economy continues to struggle. We still expect broad-based improvement thanks to the collapse in oil prices and the lower euro, continuing monetary easing by the ECB and the end of austerity. 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: The US remains the exception



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 India

GDP growth by region (%)	*2014*	*2015*	*2016*	*Δ-1m 2015*	*Robeco**
US	2.3	3.0	2.8	0.0	+
Eurozone	0.8	1.1	1.5	-0.1	+
UK	3.0	2.6	2.3	0.0	=
Japan	0.3	1.0	1.4	0.0	=
China	7.4	7.0	6.7	0.0	=
India	5.4	5.5	6.3	0.0	+
Brazil	0.2	0.9	2.0	-0.2	-
Russia	0.5	-1.2	1.0	-1.2	-

* indicates whether we expect a higher (+). matching (=) or lower (-) inflation rate than the current consensus estimate for 2015

Source: Bloomberg. Robeco

Robeco's expectations for inflation in Russia are higher than consensus

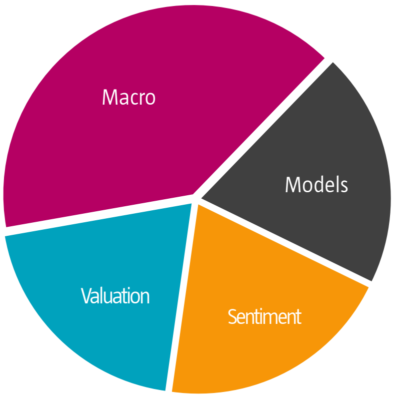
CPI by region (%)	*2014*	*2015*	*2016*	*Δ-1m 2015*	*Robeco**
US	1.7	1.5	2.2	-0.2	-
Eurozone	0.5	0.6	1.3	-0.3	-
UK	1.5	1.4	1.9	-0.2	=
Japan	2.8	1.5	1.5	0.0	-
China	2.1	2.0	2.5	-0.5	=
India	7.2	6.7	6.3	-0.3	=
Brazil	6.3	6.4	5.9	-0.1	=
Russia	7.6	8.2	5.8	0.7	+

* indicates whether we expect a higher (+). matching (=) or lower (-) growth rate than the current consensus estimate for 2015

Source: Bloomberg. Robeco

Robeco's multi-asset management approach

Input factors for our investment policy



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 macroeconomic 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 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.

	Portfolio	BM	active	previous
Equities Developed Markets	27.0%	25.0%	2.0%	9.0%
Equities Emerging Markets	3.0%	5.0%	-2.0%	-2.0%
Real Estate Equities	5.0%	5.0%		-2.5%
Commodities	5.0%	5.0%		
Core Gov Bonds 1-10	19.0%	20.0%	-1.0%	-5.0%
Core Gov Bonds 10+	7.5%	7.5%		
Investment Grade Corp Bonds	19.0%	20.0%	-1.0%	-1.0%
High Yield Corp Bonds	7.0%	5.0%	2.0%	2.0%
Emerging Market Bonds LC	5.0%	5.0%		
Cash	2.5%	2.5%		-0.5%
EUR/USD	-1.0%	0.0%	-1.0%	-1.0%
EUR/JPY	1.0%	0.0%	1.0%	1.0%
EUR/GBP	0.0%	0.0%		
EUR CASH	0.0%	0.0%		
Portfolio risk	4.84%	4.77%		

Closing date for text: 08 January 2015. We refer to calendar months in all our data tables.

Robeco Investment Solutions and Research

Jeroen Blokland. Emerging markets
Léon Cornelissen. Chief Economist
Lukas Daalder. Equities
Ernesto Sanichar. Currencies
Ruud van Suijdam. Real estate
Peter van der Welle. Strategist
Shengsheng Zhang. Commodities