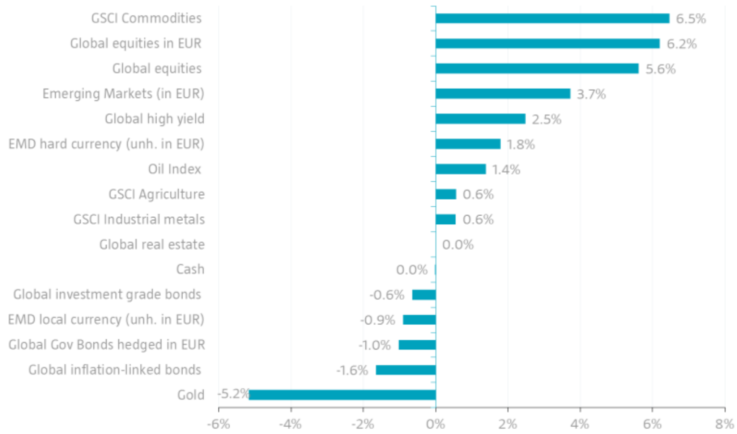
Multi-asset markets outlook

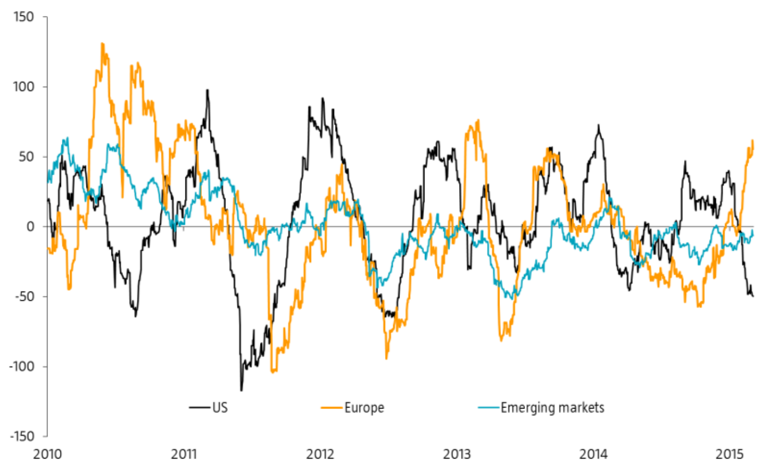
March 2015

General overview

February results: risk on!



US is switching sides with Europe, with respect to economic surprises



Citigroup surprise index

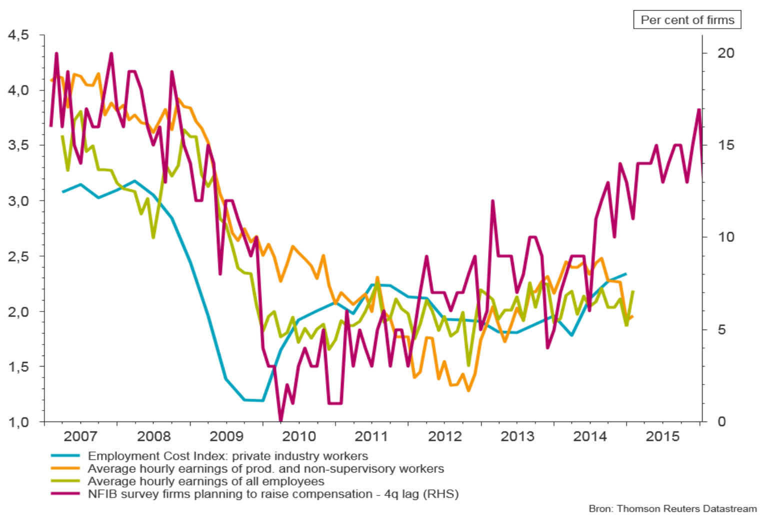
- Following the volatile start of the year, February turned out to be a classic risk-on month. Greece was saved, the Ukraine military escalation halted, and oil prices recovered. A pessimist would add ‘for now’ to all of these points, but with no less than 18 central banks announcing measures to stimulate their respective economies since the start of this year, it was clear that the markets judged it differently. All risky assets showed a healthy performance during the month, with the exception of real estate, which was taking a breather after the exceptionally strong January push. High yield experienced one of its strongest months in recent years, lifting the `what-do-bonds-know-that-equities-don’t’ fears that lingered in the markets.

- From an economic perspective, some weaker data from the US was compensated by better-than-expected results in Europe, with especially consumer demand in the Eurozone surprising on the upside. It strengthens our positive view that we continue to have on the Eurozone, although this is of course remains dependent on developments in Greece and Ukraine. As for the US, Fed chairwoman Janet Yellen has clearly created room for policy flexibility moving forward, which means that the timing of the first rate hike will depend on wage and inflation data. We have made no adjustments to our portfolio, which means that we are still cautiously overweight on risky assets.

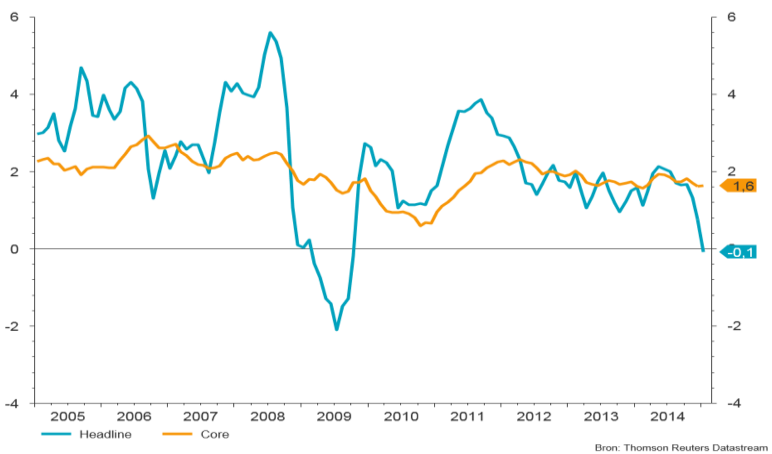
Economy

United States

Room for higher US wages



Headline deflation in the US

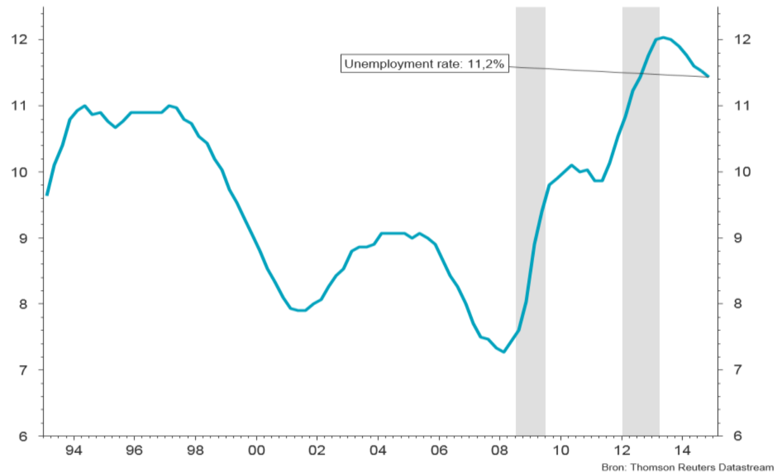


- After growing briskly in the second and third quarter of 2014, the US economy slowed markedly to a growth rate of 2.2% in Q4. The overall strength of the US dollar is probably an important factor. The growth of personal consumption is strong (4.2%), suggesting that the domestic economy is in excellent health. Heartening as well was the 4.8% growth in business fixed investment. An overall growth rate of 3.0% for the US economy in 2015 is easily within reach, despite ongoing mixed news from the housing market.

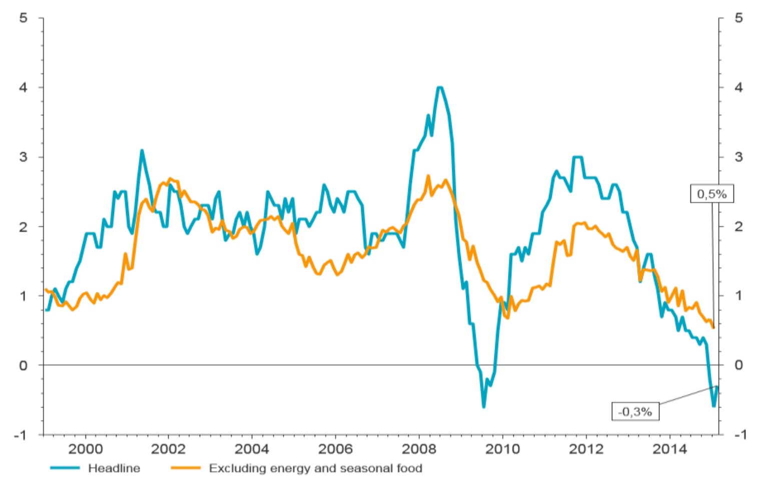
- The Fed is rightly considering the US economy to be sufficiently strong to drop its policy of forward guidance. In her testimony to the US Congress, Yellen made it clear that the central bank will shortly drop the word ‘patience’ (meaning: no rate hike at least in the coming two Fed meetings) in its statement. This doesn’t mean, however, that a rate hike is imminent. Wage growth h is still too timid. Earlier, Yellen had said she would like to see a wage growth of 3-4%. This will take some time, though the trend is clearly upwards. Moreover, headline inflation has turned into mild deflation. But the Fed clearly wants to increase its room for maneuver and to lessen its predictability. As we expect the US economy and the labor market to strengthen gradually, a first modest rate hike in the third quarter is the most likely outcome.

Europe

Eurozone unemployment declining, but still at a very high level



Ongoing deflation



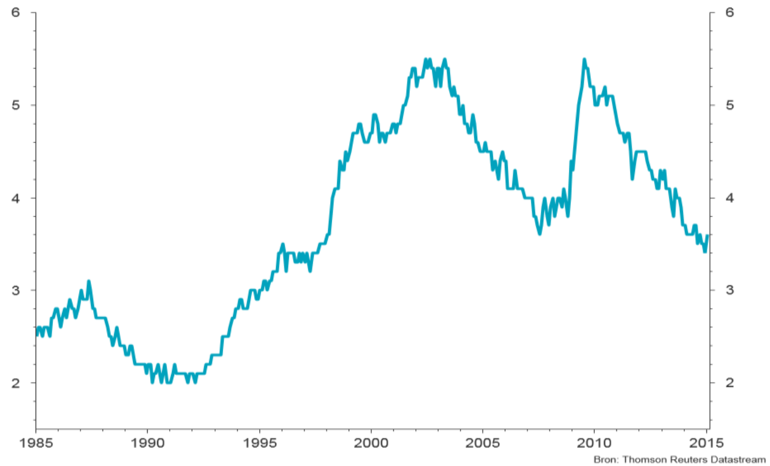
- The Eurozone economy is showing clear signs of recovery, as shown by the drop in the unemployment rate. Retail sales rose for the fourth straight month in January after rising by 1.1% from December and 3.7% from January 2014. The sustained rise in sales reflects the boost of household spending power from lower oil prices. Producer confidence is on the rise as well. The Markit Purchasing Managers Index (PMI) rose to 53.3 in February from 52.6 in January. The PMIs for the four largest economies in the Eurozone are now all above 50.

- Under these circumstances the start of the QE program by the ECB appears to be pro-cyclical. With headline inflation in negative territory for the third month in a row, this policy will not be difficult to justify by the ECB in the coming months. Still, if the recovery continues to gain strength, debates about an eventual tapering by the ECB can be expected to intensify. A growth rate of 1.5% for the Eurozone economy in 2015 is easily within reach.

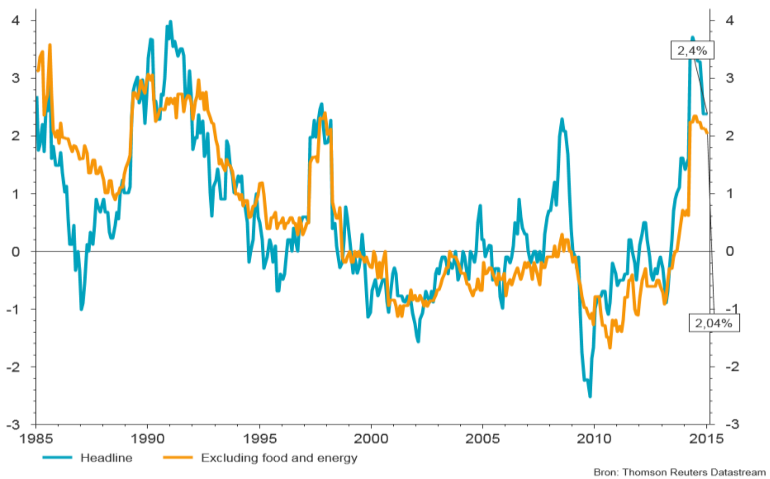
- A Greek default has been prevented by a last-ditch deal to extend Greece's bailout for four months. Though Greece is small, accounting for just 2% of the Eurozone economy, a default and/or 'Grexit' at a later stage could shatter confidence and endanger the recovery. We expect, however, the EU to go to great lengths to prevent such an outcome, partly for geopolitical reasons.

Japan

Low Japanese unemployment should push up wages



Japanese inflation falls back



- The Japanese economy is recovering convincingly from the recession in 2014 caused by the hefty VAT hike. The weakness of the yen, the collapse of the price of oil, the tightening labor market and strong corporate profits all help to put the Japanese economy on a more solid footing. Private consumption is still lagging, but an improvement in wages should help, partly due to a 'spring offensive' on wages. Business leaders have promised Prime Minister Shinzo Abe their 'utmost efforts' to raise pay. GDP growth of 1.0% in 2015 is within reach.

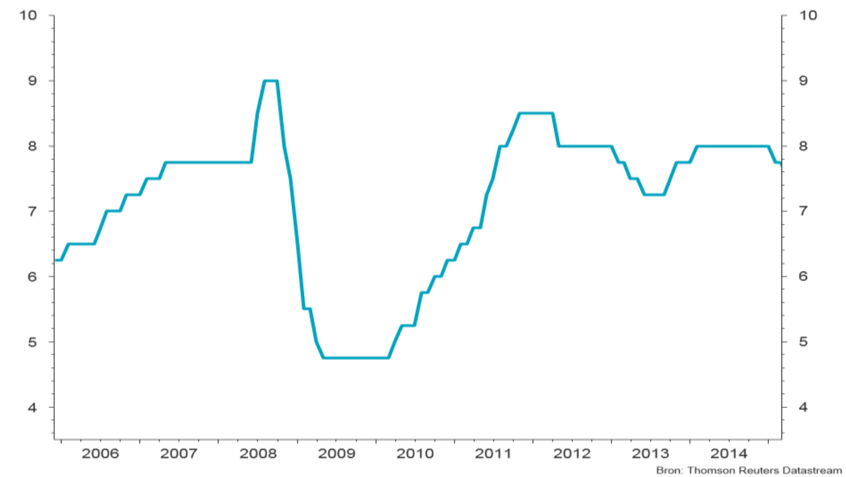
- The decline in oil prices is the main driver pushing down inflation once again. As the effects of the VAT hike will drop out of the CPI figure in April, core CPI could easily drop to become deflation once again in May. The governor of the Bank of Japan (BoJ) Haruhiko Kuroda made it clear in a recent speech that the bank still intends to achieve its inflation target of 2% within two years, and that the BoJ will make adjustments without hesitation if needed. This makes additional easing measures by the BoJ after May highly likely, possibly starting in July.

- Surveys suggest that the Japanese labor market remains tight, despite an unexpected uptick in the unemployment rate in January by 0.2 points. Interestingly, labor force participation in Japan is gradually on the rise against the background of an aging population.

Economy

Our BRICS highlight this month: India

Indian 1 day repo rate



Indian benchmark Wholesale Price Index

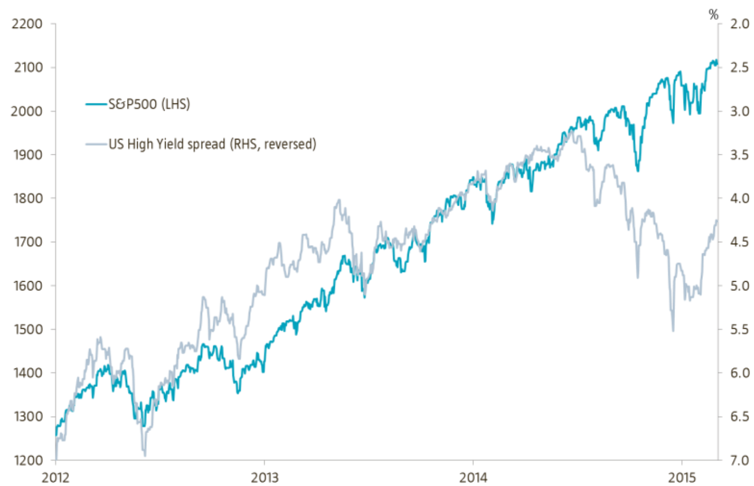
- At the end of February, Prime Minister Narendra Modi delivered his eagerly awaited first budget, an important indication of his reform drive. The budget turned out to be relatively pragmatic. The corporate tax rate will be brought down from the existing 30% to 25% in four years' time. The system will also be simplified by gradually phasing out various exemptions. Public investment in infrastructure will be increased. Some restrictions on foreign investment will be relaxed. The government is firmly committed to implement a Goods and Services Tax to replace the highly fragmentized local taxes from April 2016 onwards. The rate is likely to be relatively high: above 20%. The budget was silent on rules on land acquisition and the labor market, both of which need drastic reform to unleash private investment. Subsidies were also left mostly untouched.

- Despite the less-than-impressive budget, the Indian economy is still expected to show a growth rate of above 7.0% in 2015 and 2016.

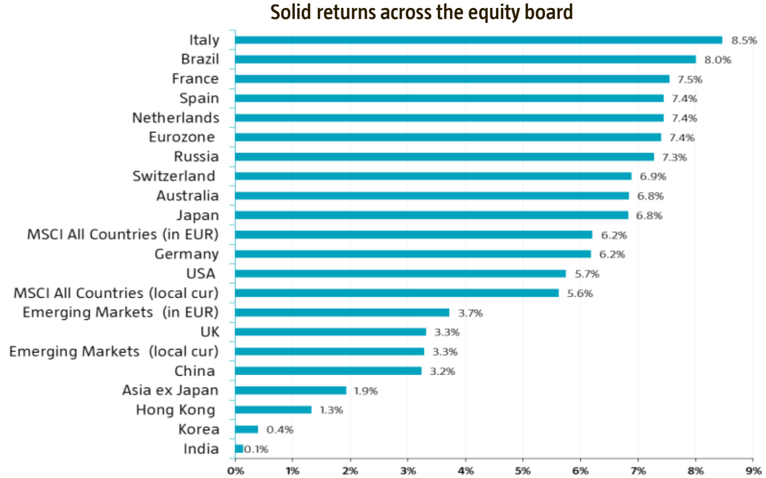
- Inflationary developments have been rather benign as illustrated by the collapse in the growth rate of the benchmark wholesale price index. This creates room for more interest rate cuts in the course of 2015. India has now switched to a system of inflation targeting: 4% plus or minus 2%. As retail price inflation amounted to 5.1% in January, a ceiling of 6% is fortunately not restrictive.

Equities (I)

Divergence between stocks and high yield appears to have ended



Solid returns across the equity board

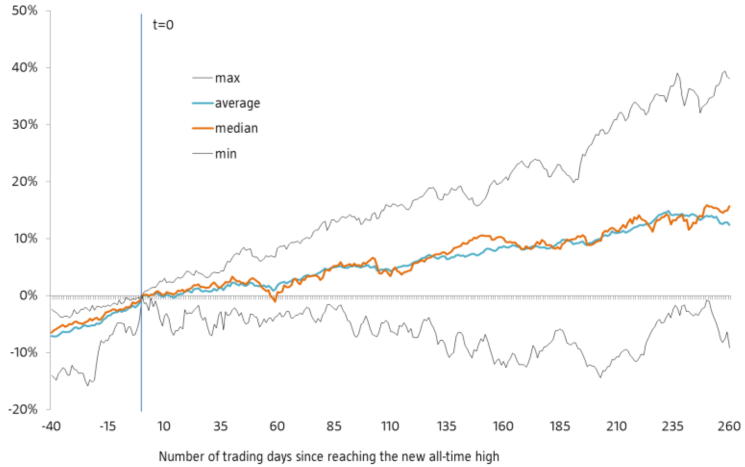


- Following the volatile start to the year, February turned into a classic risk-on month, with all stock indices posting positive returns. Europe was yet again the strongest region, while the Asian markets (ex-Japan) lagged behind. The fact that this rally in stocks was accompanied with a recovery in the US High Yield market lifted the `what-do-bonds-know-that-equities-don't' fears which had resulted in some nervousness in stock markets since the middle of last year. The solution to the Greek debt debacle that was reached in the middle of February, the firming of European macro data, as well as the stabilization and partial recovery in oil prices all helped lift stock prices, triggering a new leg in the rally that started back in 2009.

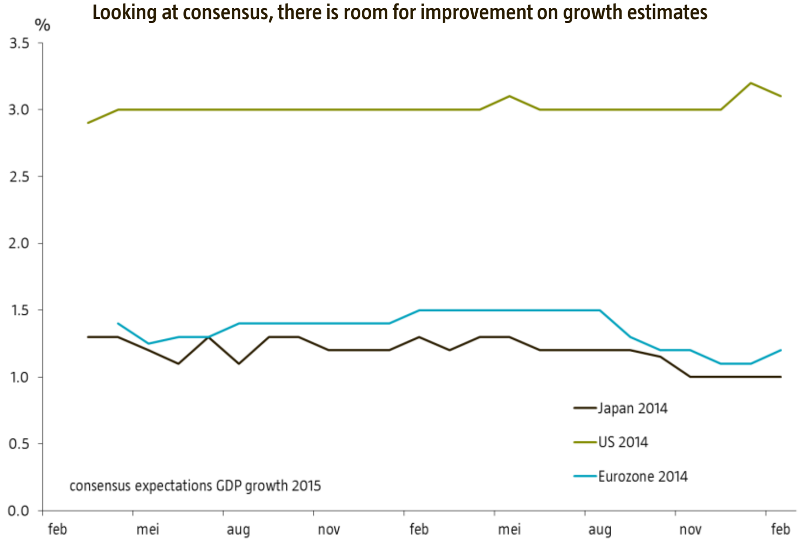
- Taking a step back and looking at this particular rally, there is no escaping the fact that it has been pretty impressive. All of the major US stock indices are trading at or near all-time highs, with even the Nasdaq just inches away from breaking the famous March 2000 high; the peak from which followed the even more famous 78% crash. It is not just the US that is trading at record highs: the Nikkei is also at a 15-year high, while even most European indices have managed to pass the break-even levels of 2000, if we take dividend payments into account. Excluding dividends, European stocks are now at the levels last seen in 2008.

Equities (II)

A new high is seldom a cause for a correction in stocks



Looking at consensus, there is room for improvement on growth estimates



New all-time highs (or even 15-year highs for that matter) always raise concerns that stocks have risen too high and are due for a correction. We saw the same concerns when the S&P500 and Dow Jones broke through their highs back in March 2013. As we indicated at that time, there is no historic evidence that reaching uncharted territory raises the risk of a correction. Looking at data going back to the 1950s, US stocks have hit a new all-time level ten times. Only once did stocks turn negative shortly after reaching the new record, but the average return of 13% in the 12 months that followed clearly indicates that we should not be worried by a new high in itself (see chart).

– Whether stocks will move higher or not will ultimately depend on a number of variables. One of these is the state of the world economy, and more specifically earnings. Disregarding potential negative events like a 'Grexit' or an escalation of the Ukraine situation, the outlook for the world economy is pretty solid. The longer-term implications of the decline in oil prices is a net positive for the better part of the world, while Japan and Europe stand to benefit from their currency adjustments. As for earnings, the strong decline in the price of oil in combination with the strength of the US dollar have led to a substantial re-rating of US earnings during the past two months, while European earnings have been steadily lowered during the course of the past nine months. . At an average >>

Equities (III)

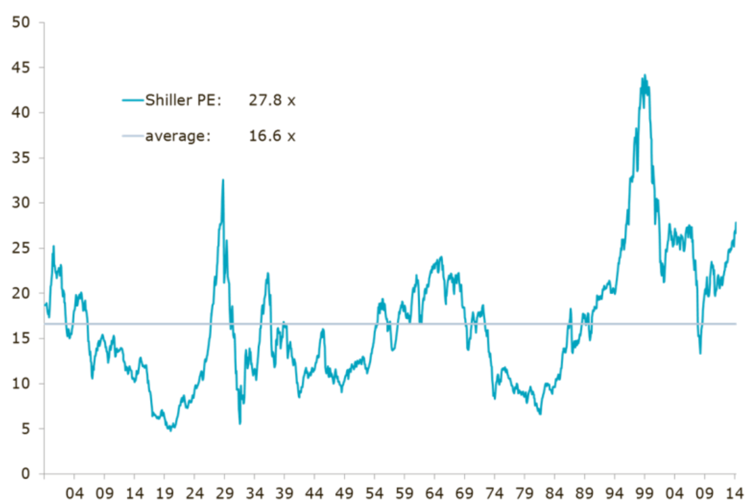
We expect 2015 to be a more volatile year, which is why we have a lowered our risk profile

Table 4: '15e EPS growth expectations vs start of last year

	Jan-14	Current
MSCI World	11.0%	3.5%
S&P500	10.9%	2.4%
Stoxx600	11.9%	5.7%
Topix	10.0%	9.5%
EM	10.3%	8.4%

Source: IBES

Stocks are not cheap. Than again, what is, these days?

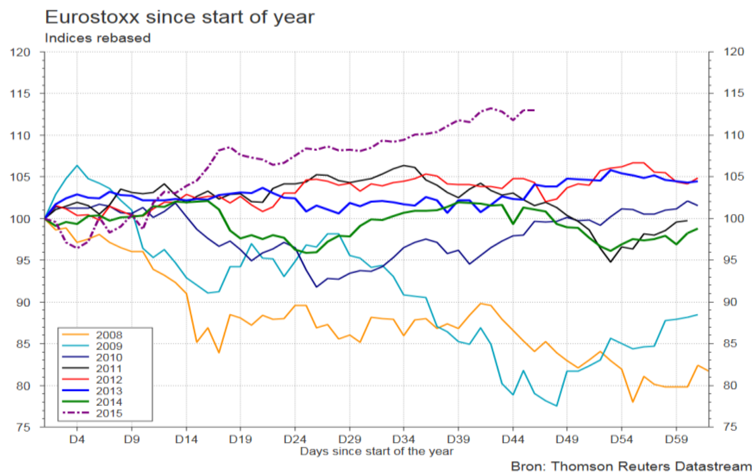


expected EPS of only 3.5% for the MSCI World in 2015, earnings expectations look a lot more realistic than they normally do around this time of the year. To put it differently, from these levels, stocks could actually be supported by earnings upgrades moving forward.

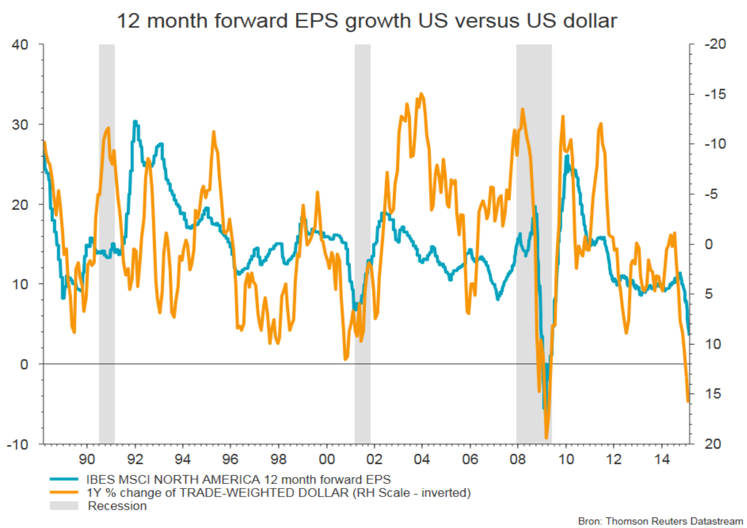
- A second factor determining the fate of stocks is valuation. Our preferred valuation matrix continues to be the cyclical adjusted PE ratio, a.k.a. the Shiller PE. For US stocks, this matrix has reached a level close to 28, a level only seen during the roaring twenties and the more recent run-up to internet bubble. Although this indicates that US stocks are indeed expensive, the level of overvaluation is a lot less threatening when we look at an international measure of the Shiller PE. On balance, stocks are expensive, but that applies to almost all assets these days. With liquidity still ample and the search for yield still a main driver, current valuations do not pose a serious hurdle for the market just yet. It will be a cause for higher volatility though, as stocks are expected to become more sensitive to earning surprises moving forward. Looking at momentum (QAS models) and our quantitative models confirms the view that stock markets are likely to move higher in the months ahead, which is why we hang on to our slight overweight position in equities.

Developed Market Equities (I)

Strongest start in seven years for Europe



Analysts seem (too) realistic about negative dollar impact

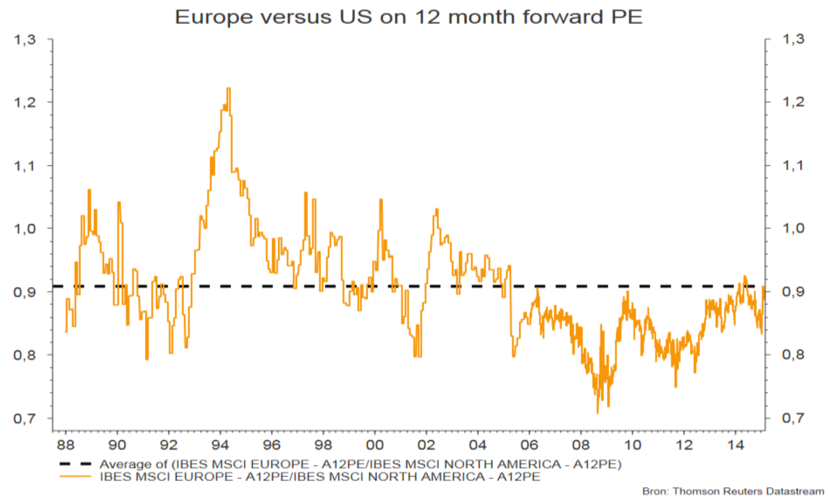


- Records inflows were recorded for European equities this month, and macro surprises suggest the tide is shifting in favor of Europe versus the US. Nevertheless, sentiment in the US also remained strong, and the Nasdaq broke through the 5000 barrier, a level not seen since the year 2000. Analysts have further downgraded US earnings relative to European earnings, in line with the dollar's appreciation. However, matching EPS growth with the move in the dollar (see second chart), it looks as if the market has overreacted somewhat over the dollar's strength. This should in principle mitigate a further drop in forward earnings, which have been downgraded in the US as if we are entering recession territory. Also, although wage growth is expected to pick up, it is still on the sluggish side, and profits in the US have remained resilient to wage pressures so far.

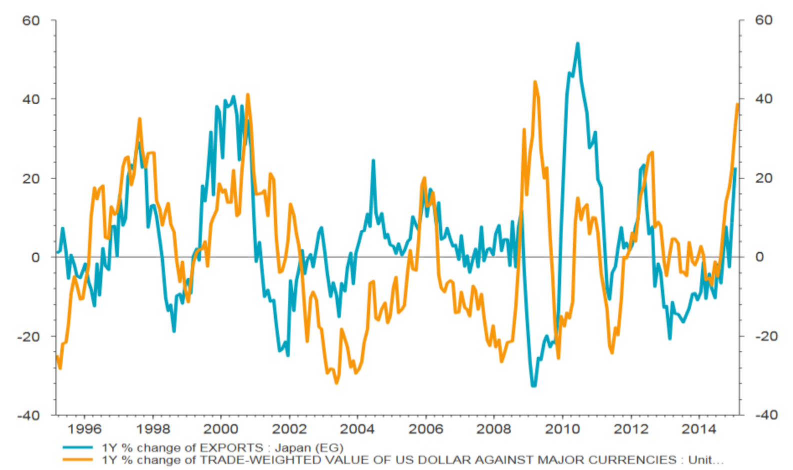
- Diverging monetary policy sets the tone for regional equity perspectives as the BoJ and the ECB are clearly in QE mode, while the Fed is pondering the timing of its first rate hike. The effect of competitive devaluation on relative regional earnings has turned to the favor of Japan and Europe. Although the ECB says it does not target a lower euro, we think the exchange rate is the main transmission channel for reflation in the Eurozone.

Developed Market Equities (II)

Valuation – Europe getting more expensive, approaching its historical 9% discount



Japanese exports are picking up as dollar strengthens

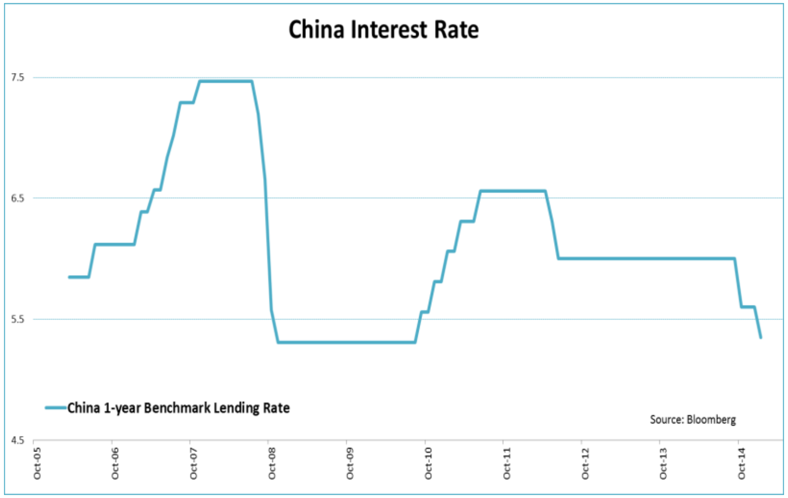


- Valuations in Europe increased as we have seen a strong re-rating of European equities. European valuations are now close to historical averages relative to the US on a 12-month forward price- to earnings metric, leaving not much upside left from a valuation point of view. Relative momentum is currently strongest for the Eurozone within developed markets, as many investors buy the story that the ECB's QE will a) bring higher overseas earnings for European corporates through a lower euro, b) lower corporate funding costs and c) boosts producer confidence. A lower oil price is an additional boon for the Eurozone, a net oil importer. Although we tend to agree with this upbeat story, there are some pitfalls, because:

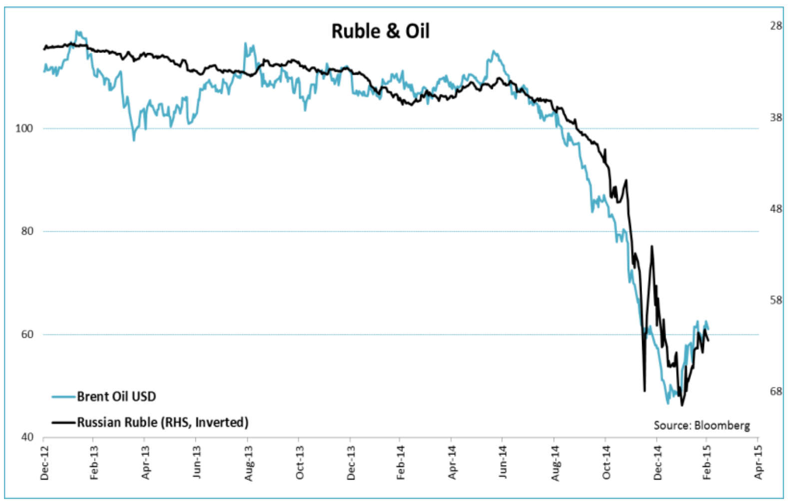
- Our quant model has turned the signal to neutral from overweight for Europe . Europe has now become a consensus trade and although there seems to be upside left, sentiment in the Eurozone remains particularly vulnerable to political developments as the tensions in Ukraine remain elevated. Also, the left-wing Greek government and Germany have dug in hardline positions. The presence of political risk has caused European equity volatility still to be elevated compared to other regions. While recognizing these risks, we prefer an overweight to Japan, where earnings prospects are still improving. We retain our neutral stance towards the US.

Equities: Emerging vs Developed (I)

China lowers interest rates



Oil price recovery helps Russia



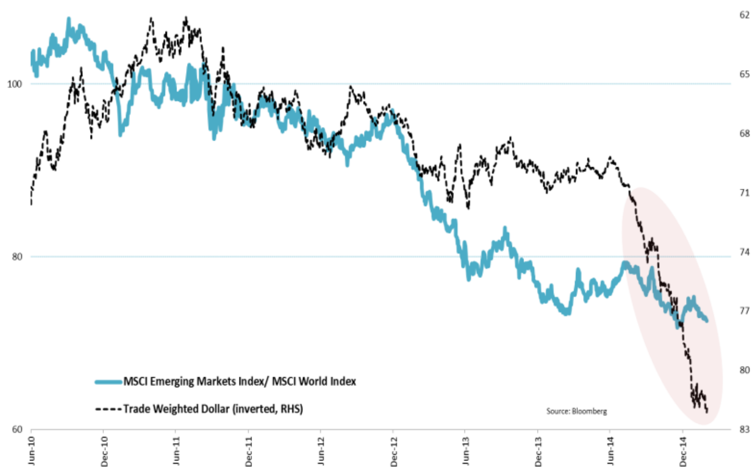
- The outlook for emerging markets does not look all that different from last month. Growth is struggling as a result of secular and temporary factors. China lowered short-term interest rates for a second time to make sure growth doesn't fall back further. Officially though, the rate cute by the People's Bank of China is not meant as stimulus. The bank stated explicitly that the rate cut is aimed at cancelling out higher real interest rates as a result of declining inflation (CPI rose just 0.8% in January) and does not imply a change in monetary policy. We think, however, that more rate cuts are likely as GDP growth cools down over time.

- Slower growth in China impacts other countries in the region as well. In the last round of manufacturing PMIs, many Asian countries saw their index decrease, pointing to slower growth going forward.

- Russia's economy still looks pretty ugly, but a rebound in the price of Brent oil gave the Russians a bit of breathing space. The ruble and PMI rebounded together with oil prices. Still, a severe recession will evolve this year, and probably next year as well. More sanctions loom ,and given current production levels, oil prices may fall again. Political tensions will remain for the foreseeable future.

Equities: Emerging vs Developed (II)

The strength of the US dollar remains an important risk



Valuation of emerging markets is attractive

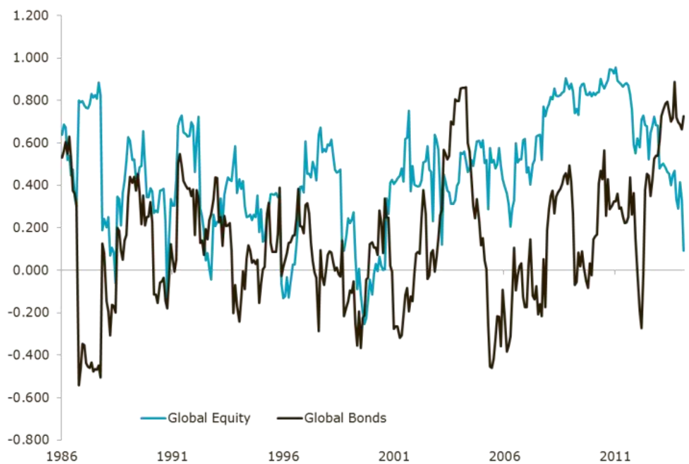
- As mentioned many times before ,a stronger US dollar often means trouble for emerging markets. And while Yellen strains herself to convince markets that the Fed will take it very easy, a rate hike this year is still very much on the table. In a world of ever -looser monetary policy elsewhere (with the exception of Brazil), more dollar strength can't be ruled out. In recent weeks the brief spell of emerging market outperformance has vanished.

- Earnings development has not improved much lately. Oil prices and slightly lower interest rates have had some impact on earnings, but earnings growth is still lagging in emerging markets. Valuation is attractive, but has been so for a while. Valuation doesn't function as a catalyst for out- or underperformance most of the time.

- For now we remain underweight emerging markets. Fundamentally, things have not yet significantly improved. Furthermore ,we expect the 'threat' of a rate hike by the Fed to be of bigger impact than the loosening of monetary policy elsewhere in the world. Further US dollar appreciation remains likely, which dampens the outlook for emerging markets.

Real estate

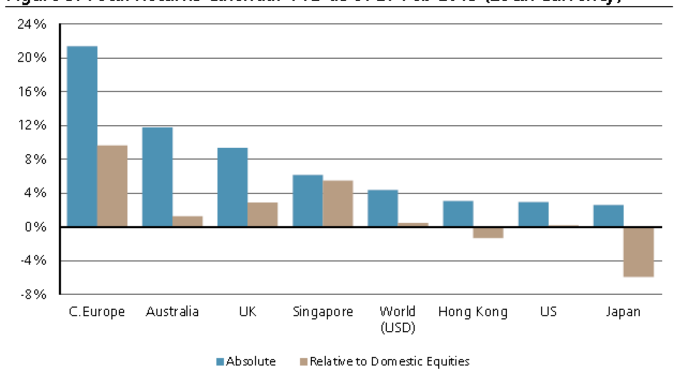
One-year rolling correlation of equities approaches zero.



Source: Bloomberg, Robeco

Relative performance of global real estate

Figure 3: Total Returns Calendar YTD as of 27 Feb 2015 (Local Currency)



Note: As of 27 Feb 2015. Source: FTSE, EPRA, NAREIT, Thomson Reuters DataStream, UBS estimates. Regional real estate total return figures calculated using the FTSE EPRA/NAREIT (total return) real estate indices.

- After the real estate rally in January, fueled by the bond buying program of the ECB, real estate markets took a serious break. The performance of global real estate (in euros) was exactly 0% in February, fully erasing the outperformance against global equity (in euros). Both asset classes have returned around 12% so far this year. The correlation between interest rates and the performance of real estate is still present, on a global level at around 0.7. The rolling year-on-year correlation with equities has steadily declined and now is approaching zero. This means that real estate could be a good diversifier for equity investments. So, from a portfolio perspective, real estate is an interesting asset class. Besides the low correlation with equity, it provides a stable dividend that is significantly higher than bond yields. A rising bond yield, what we ultimately expect, will have a negative impact on real estate.

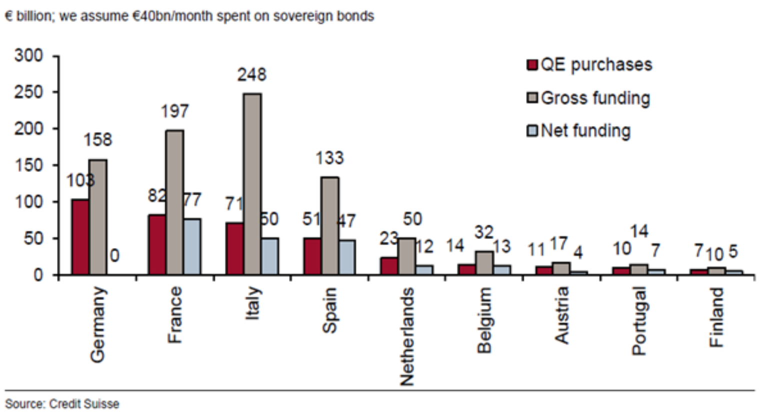
- However, the valuation of real estate is stretched, to put it mildly. Real estate in the US is expensive compared to equity in terms of the FFO multiple (comparable to the equity PE) and to their own history. So far, investors don't seem to be bothered though, as it is the dividend yield that counts. The same is true for Japan, where BoJ buying of J-REITs pushed valuations higher.

- All arguments put together, we keep our neutral position for real estate.

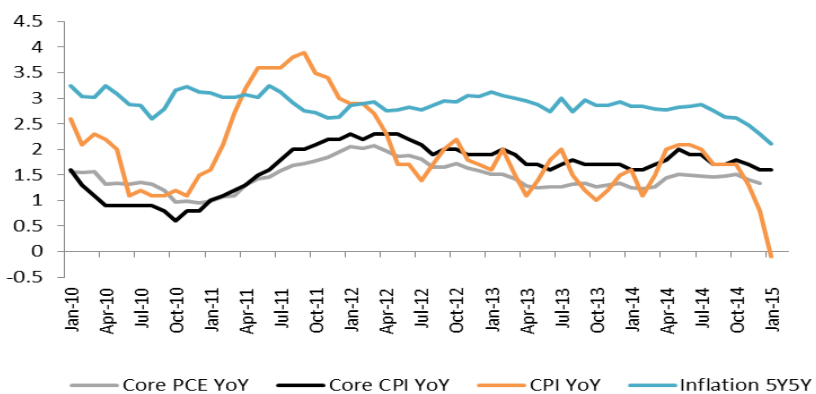
ROBECO

AAA Bonds (I)

Due to relatively small budget deficit s, net supply is not matched by the increase in demand in the Eurozone



The inflation picture is less straightforward in the US



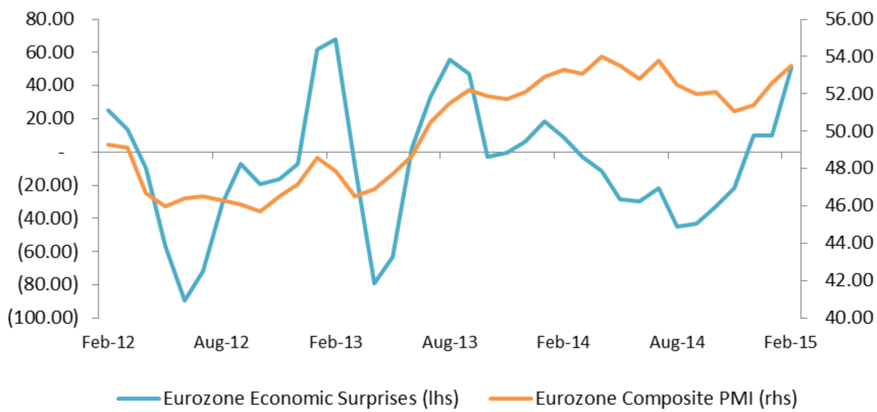
- With the ECB finally starting its long anticipated purchasing program, and the market generally expecting it to last until September 2016, we need to start thinking about new drivers for the rates market. Does this mean that the gravitational pull lower of the buying program is over? No, not at all, but we do need to be aware of other forces that might mitigate the pull lower. In this regard we think a change in Fed policy and a pick-up in European growth are two developments worth monitoring carefully over the coming period.

- If history is a guide we should expect the impact of a rate increase in the US to be a global rather than a local event. When you look at the performance of the US economy, which has been pretty good over the last couple of months, and put this against the monetary policy of the Fed, you can't help but think that there is a disconnect. Against an improving economy the Fed is still running a policy that is focused on fighting an emergency/disaster situation. The reason is understandable, given that the risk that comes with hiking too early are just too big. Furthermore, the dual mandate of the Fed gives it some room for maneuver, as the picture stemming from inflation is more complicated. Yes, inflation expectations still seem well anchored, but inflation has been in a downward trajectory for the last couple of months.

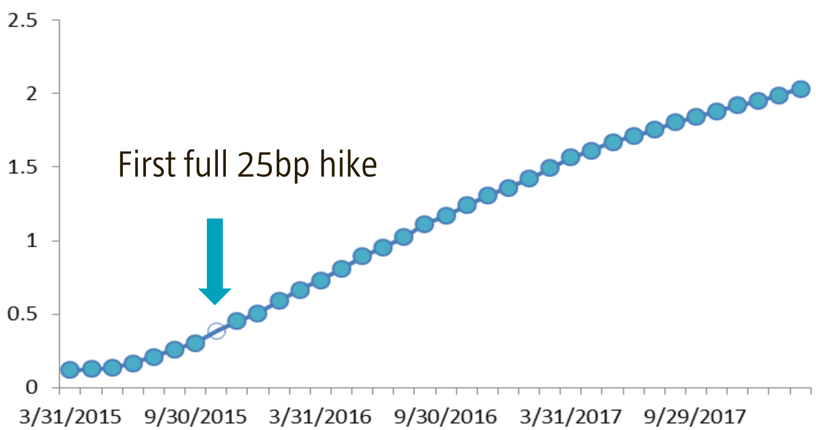
Fixed Income

AAA Bonds(II)

Economic momentum seems to be picking up



First fully priced 25 bp Fed hike according to Fed fund futures



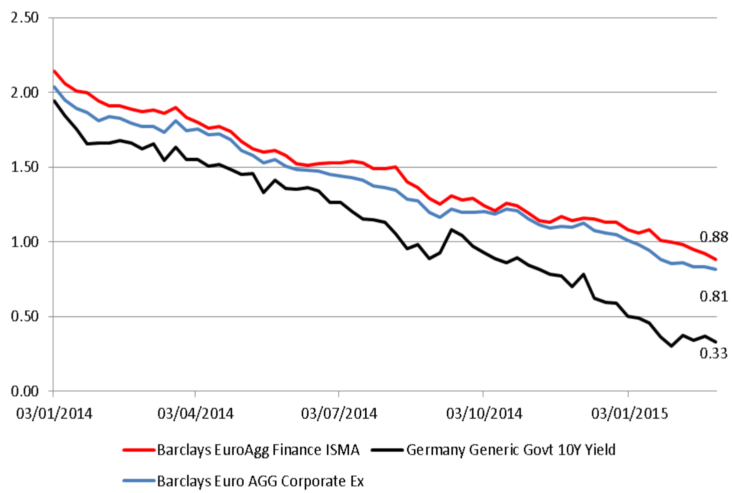
- Taking all of this into account, we agree with the market that in the third quarter we may be faced with the first rate hike.

- We have been positive on European growth for quite a while, and its good to see that this view is finally getting some traction. The upward trajectory in both economic surprises and purchasing indices, and also the improvement in the demand for loans from businesses strengthen our believe that the recovery has legs. We will monitor inflation expectation in the Eurozone closely to see if the markets are starting to price in reflation, as we consider this a risk to our current view. An indirect effect of the positive growth story might also be that the ECB starts to be less coherent. This may make the market suspicious whether the buying program will be fully executed, which is essential for the supply/demand mismatch theme.

- For the moment we are comfortable sticking with the supply shortage story. We therefore continue to be overweight on duration. As recommended last month, we prefer to have longer-dated European bonds, and have a preference for non-core. This is to capitalize on further downward pressure on rates due to purchases by the ECB.

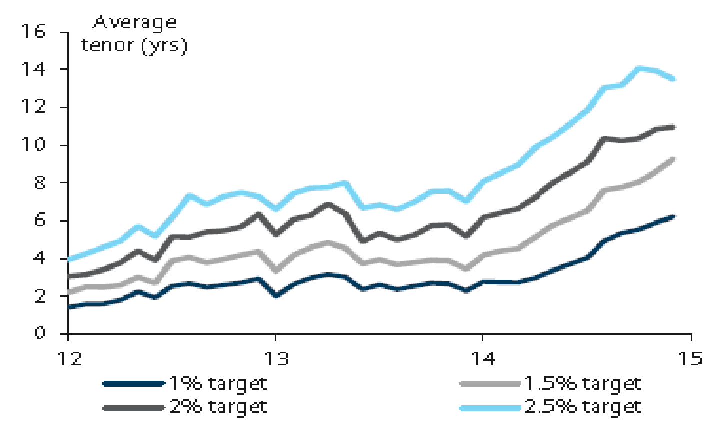
Investment Grade Credits (I)

European credit yields and the Bund yield



Longer duration needed to get some yield

The duration risk required to achieve target returns has risen



Note: Based on Barclays Agg Corp ex Sub Index. Source: Barclays Research

- February was a relatively good month for investment grade European credits. A lot of good news supported the credits: the Greek risk went off the table, at least for a while, there was a ceasefire in Ukraine, and positive surprises for the European economy. So, with these risk factors fading away, and with start of the ECB's bond-buying program, spreads came in, especially in the second half of the month.

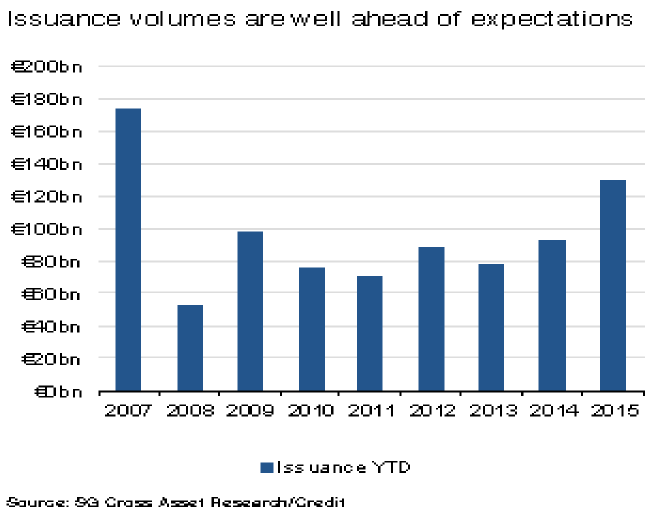
- Yields have fallen well below 1% for European credits now. As can be seen in the top graph, spreads of European Financials came in faster, while the government bond yield was merely flat.

- In order to have at least some yield, investors have to move to the longer end of the curve. In 2012, a tenure of 2 years was enough to have a yield of 1.5%, whereas now a maturity 8 years from now is required. For higher return targets, this effect is even more pronounced. We think 2.5% yield for a period of about 14 years doesn't reflect the true credit risks that they contain.

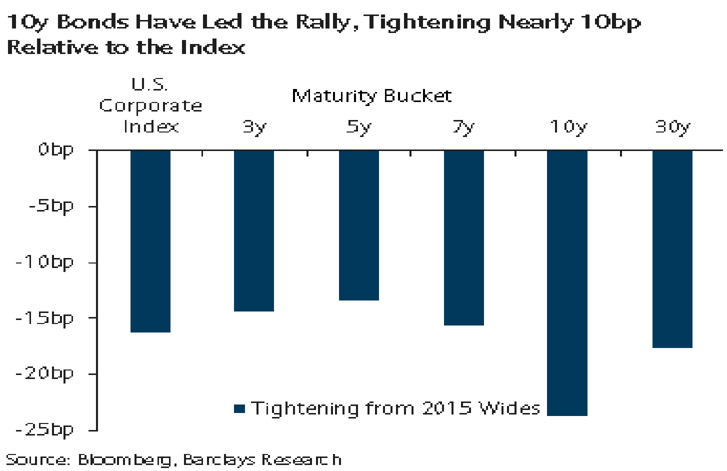
- Despite the positive signs last month, risks aren't off the table. We think the upside potential for European credits is limited. Yield has to be found elsewhere.

Investment Grade Credits (II)

Issuance of corporate credit



Spread tightening in the US in the medium term



- In the US, It is attractive for corporates to issue new debt, so issuance volumes in the US are rising (European issuance is slowing down actually). About half of the new issuances in the US is stated in euros, in order to profit from the difference in yield. The rising issuance of US corporates gives some breath to the tight euro credit market.

- Where European yields continue to slide, US credit yields are moving upwards. However, US spreads tightened as the Treasury yield in the US went up more. Most spread tightening took place in the mid-term segment, where the 10-year segment came in nearly 25bps from the highest point so far this year. Yields for corporates in the US closed around 3% this month (measured in euros, this is 2.6%).

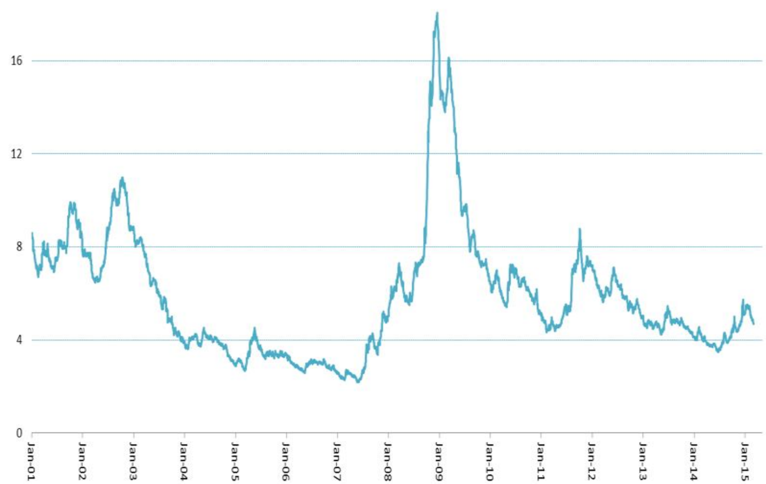
- A rate hike would hurt US credit performance, but the indication is that this will not occur in the coming months. Keeping the search-for-yield mantra in mind, US credits might be an alternative for their European counterparts. We have an underweight position in European credits. Investors looking for yield might could take a look at US credits as an alternative, but they must be aware of the slightly higher risk profile of US credits, and the currency effect.

ROBECO

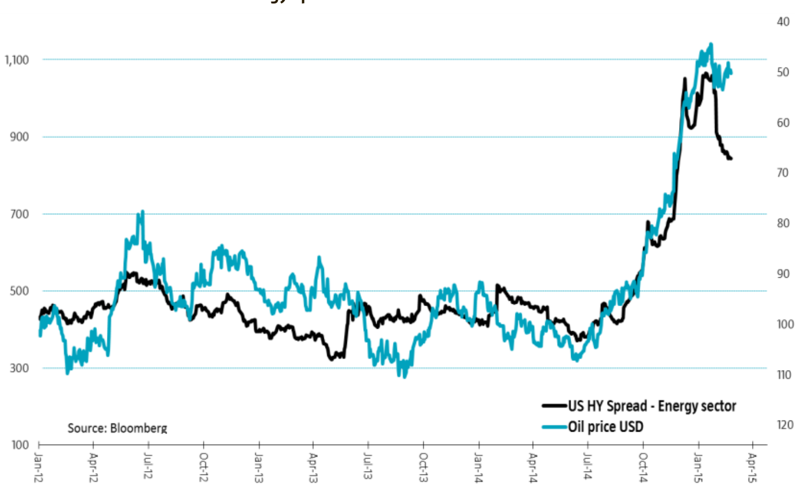
High Yield (I)

Fixed Income

High Yield spread



Energy spreads decreased



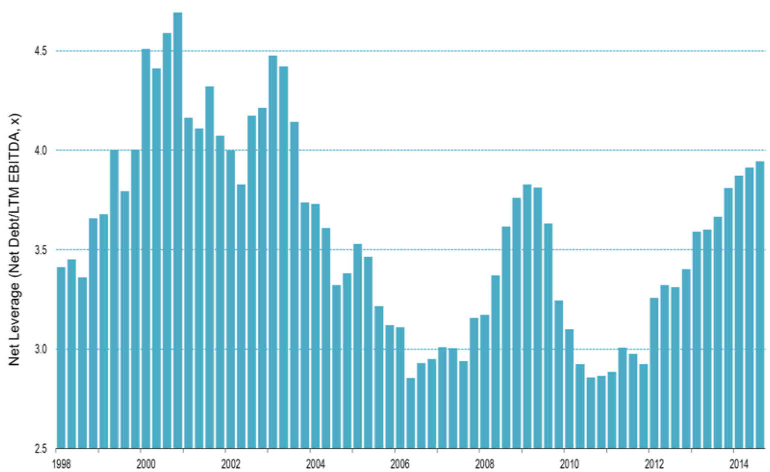
- Driven by a positive sentiment in financial markets, High Yield experienced one of its strongest months in recent years. An immediate 'Grexit' was avoided and looser monetary policy around the globe (the US being the only major exception) revived the quest for yield. The Global High Yield Index (hedged to euros) increased by 2.5% in February. Since the end of January the spread on high yield bonds has contracted significantly (76 basis points.)

- Energy companies were the biggest gainers within the Global High Yield Index as oil prices stabilized. It was the energy sector's strongest month in six years, with a total return of 5.5%, and also the first positive month since August last year.

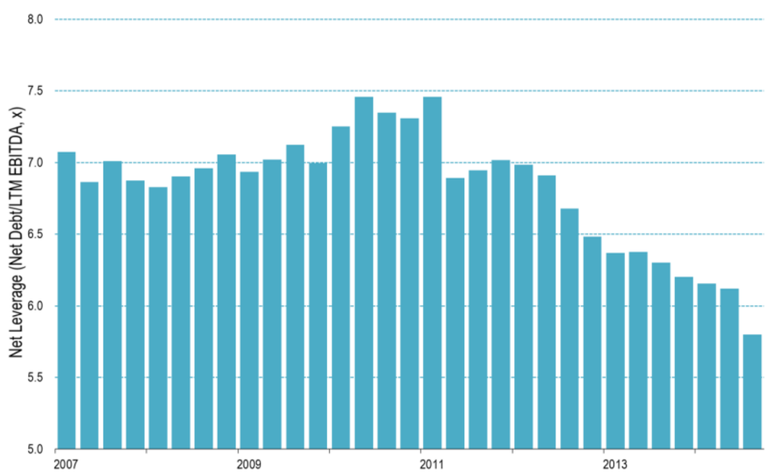
- The graph to the left shows that the strong return on energy-related bonds came as oil prices stopped their decline. This underpins our view that investors did not discriminate enough between those companies in real default danger and the healthier companies when oil prices were falling. As the oil-related turmoil weakened, investors paid more attention to fundamentals again, with lower spreads as a result. That said, given the strong growth in oil production, another drop in oil prices can not be ruled out at this time.

High Yield (II)

Leverage ratios are increasing...



... but effective interest costs are falling



- Over the last couple of years the leverage ratio of high yield companies has steadily increased. While this has deteriorated the fundamental outlook a bit, these levels are not that troublesome when current interest rates are taken into account. The graph below shows that interest costs have actually gone down as bond yields have fallen sharply. Effective interest cost levels are significantly lower than a few years ago.

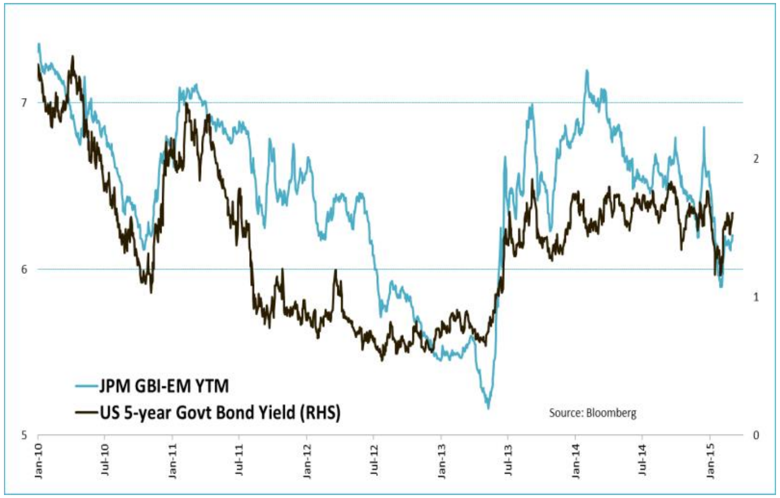
- High Yield still offers an attractive valuation against both investment grade bonds and equities. Investment grade credit spreads have remained extremely low as a result of the announcement of QE by the ECB, while high yield spreads have widened somewhat. Compared to the earnings yield for equities, high yield remains attractive as well.

- We continue to be marginally overweight in high yield bonds (especially against cash). We think that the extreme loose monetary stance of many central banks will force investors towards riskier asset classes. This should lead to reasonable returns for high yield bonds compared to the returns on cash, government bonds and credits.

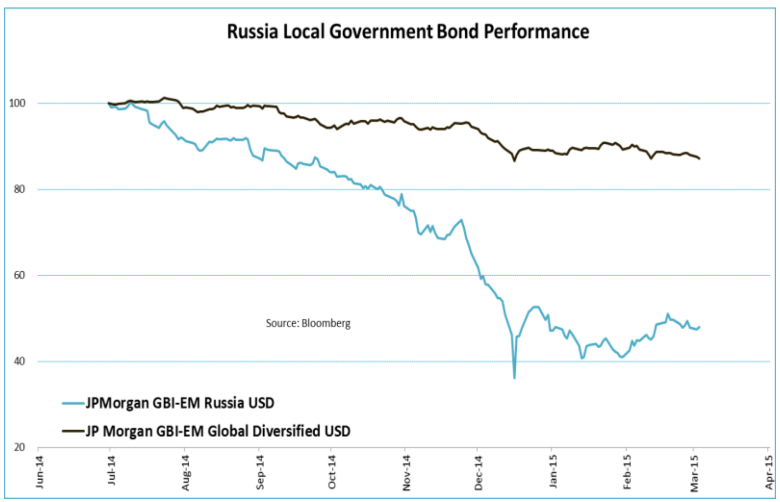
ROBECO

Emerging Market Debt (I)

Yield to Maturity



Russian Local Currency bonds



- Spreads on emerging market debt (EMD) narrowed marginally over the last month. As has been the case for quite some time now, spread movements are the least important factor concerning EMD returns. As the graph to the left shows, the somewhat volatile movements in US interest rates are of bigger importance. After a sharp drop at the start of the year, the 5-year US Treasury yield rebounded as macro data and Yellen's testimony on rates emphasized that a Fed rate hike is likely.

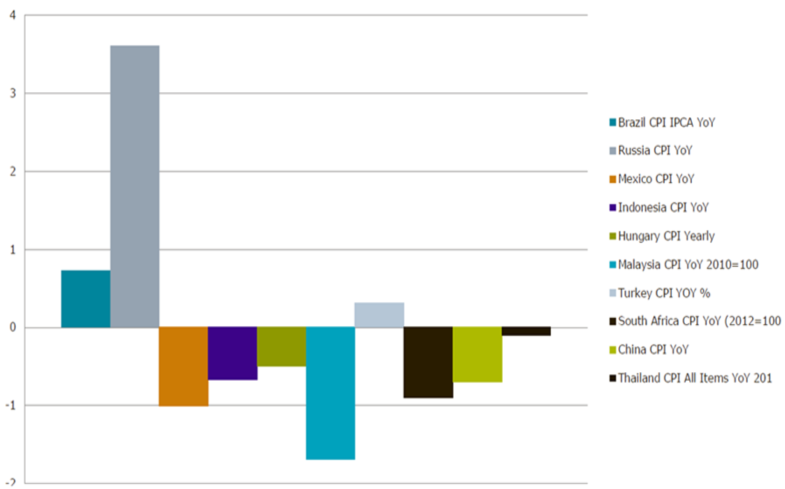
- Russian local currency bonds stabilized as oil prices ended their steep decline and no additional sanctions were inflicted ... yet. The ruble and some forward-looking macro data (for example, the manufacturing PMI) strengthened and brought some relief. However, since the weight of Russian local bonds has fallen to just 4%, against the maximum 10% less than a year ago, any recovery in Russian bonds will have a limited effect on the overall index.

- Furthermore, Russia remains the most volatile and unpredictable part of the EMD universe. Oil prices are not expected to rise that much in the short term. Also, the economy is under severe pressure, currency reserves are dwindling and a bold move by the central bank to lower short-term rates could still backfire.

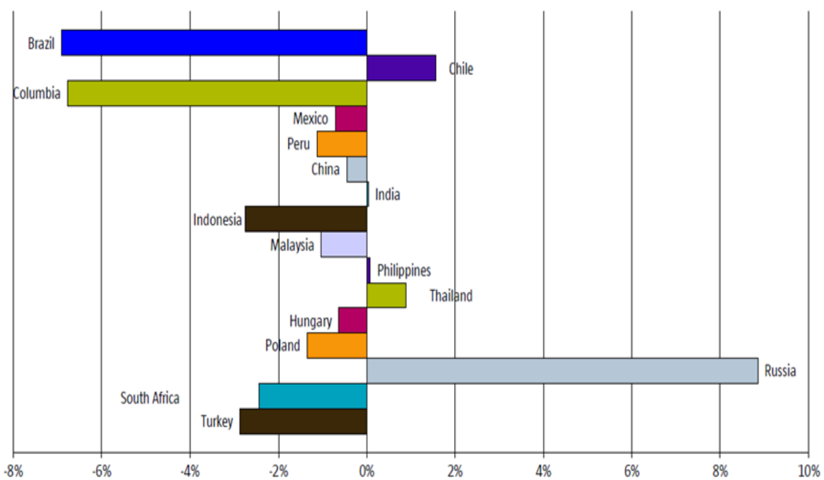
Fixed Income

Emerging Market Debt (II)

1-month Change in inflation



1-month change in EM FX

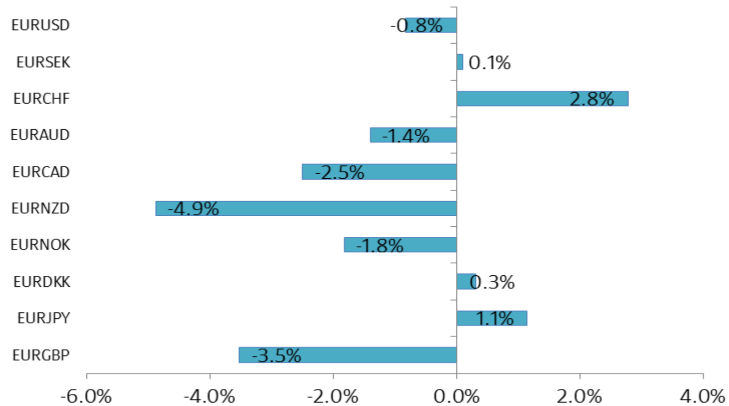


- Lower oil prices have led to lower inflation levels in most emerging countries, as is shown by the graph on the left. Next to Russia, Brazil is the only other major exception. Interest rates are expected to go up here. Meanwhile, Brazil's currency, the real, is weakening. The outlook for Brazilian local government bonds remains poor. But for most countries in the EMD universe, lower inflation offers room to loosen monetary policy. Indonesia, Turkey and Peru have already lowered rates this year and more rate cuts are expected. This is a positive for EMD.

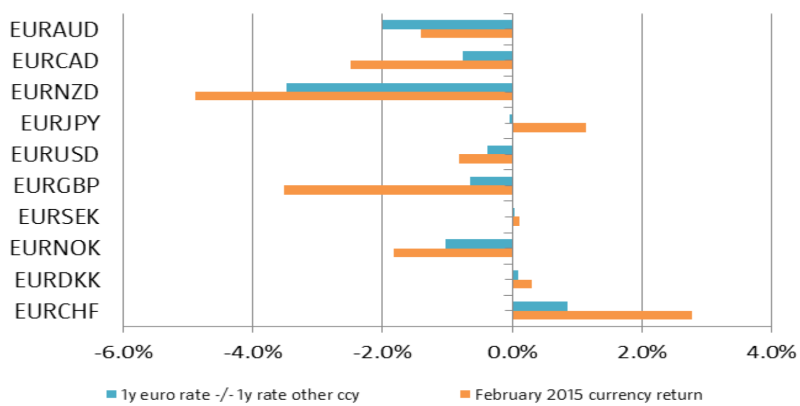
- Meanwhile, emerging market currencies remain under pressure, especially against the US dollar. With the exception of Russia (already mentioned before), most emerging currencies depreciated against the dollar as a US rate hike looms. While we should take into account that ultimately returns are measured in euros, the outlook remains subdued. We expect emerging market currencies to fall against the dollar. Current accounts are improving slightly this and next year, but they remain negative for most countries. On top of that we expect emerging market currency volatility to remain relatively high for a considerable time. Much of the effects and imbalances that result from aggressive maneuvers by central banks around the globe are reflected through currencies. We stay neutral on emerging market debt.

FX (I)

The euro is still depreciating against most G-10 currencies



Higher interest rates are still supportive for currencies

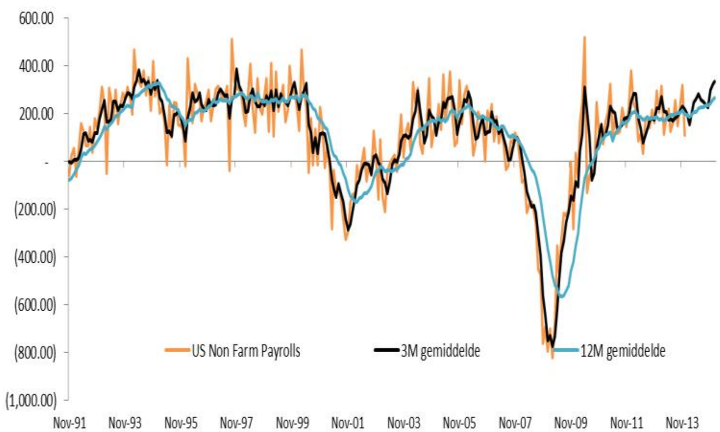


- So now that the ECB has finally started its long-anticipated buying program, what will happen next? The general expectation is that the euro will weaken further. That is the conclusion that can be drawn from past experience (sterling, yen, US dollar). When looking at the returns of the past month this still seems to be the right view. The euro only strengthened against the yen (still in QE mode) and against the Swiss franc, which saw a small retracement after the massive 14% decline in January.

- The crosses against which the euro depreciated all have short-term interest rates (1-year swap rates) higher than that of the Eurozone. Not that all these central banks are expected to tighten policy; for the moment, we only think that this is the case for the US and the UK . Already in the first months of this year around 18 central banks have eased policy. To stand out in such an environment is only possible if you out-ease every one else. That is exactly what the market expects from the buying program of the ECB, and we think this is already priced firmly into the euro side of the currency crosses. A risk is any indication that the ECB can't live up to its promise and starts back peddling. This might happen if data in the Eurozone continues to strengthen.

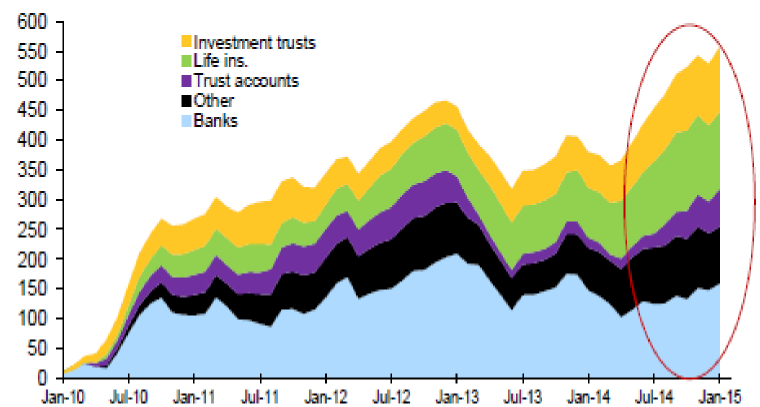
FX (II)

The US economy is rapidly adding more jobs



Money is flowing out of Japan

JPY 100bn, positive number means outflows from Japan



Source: Credit Suisse, Japan Ministry of Finance

– In the short term however, we think that not the euro part, but the other leg of the currency crosses will be an important driver.

– To determine the future path of the euro/dollar cross we need to look towards the US. Based on the latest Fed-speak it is obvious that incoming data will be very important. A continued improvement in the labor market and wage increases are essential for the Fed to start a tightening cycle. What we did notice is that Yellen went to great lengths to create policy flexibility. To us this means that the Fed is saying goodbye to forward guidance, a policy that has been in place for the last couple of years. A consequence of this is an increase in volatility around the release of important data. For the yen we think the picture is a bit clearer : no end to quantitative easing, of which a new round is still very probable. We are also watching portfolio outflows very carefully as this is an indication that locals are reacting to QE.

– We continue to believe that the dollar will strengthen further. For the moment we prefer to capitalize on this by having a short yen position. We continue to look for opportunities to increase this position and to add a long dollar position against the euro.

Important information