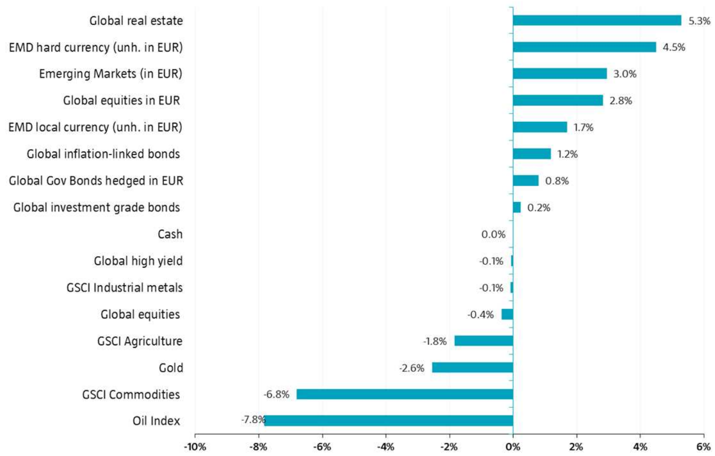
ROBECO

Multi-asset markets outlook

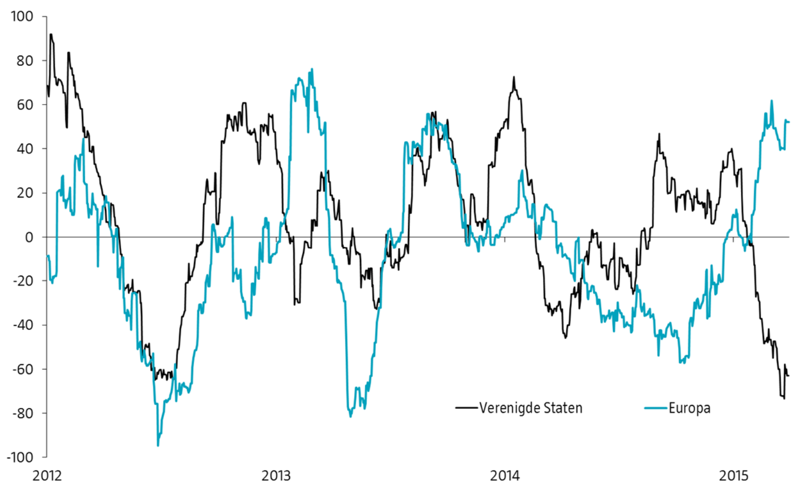
April 2015

General overview

March results: more of the same



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



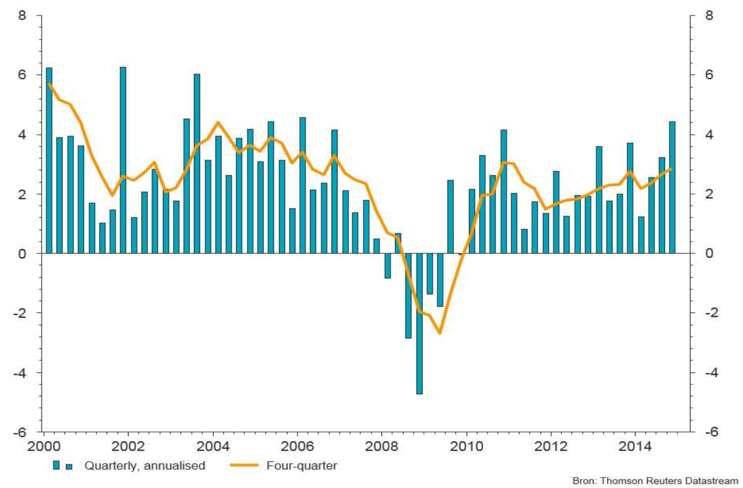
Citigroup surprise index

- Just their luck. It took months for the ECB to get to the point of starting the Quantitative Easing (QE) program, buying bonds to support the European economy. Even before the first bond was bought however, economic data started to improve, the consumer buoyed by lower oil prices while the export sector started to reap the benefits of the decline in the euro. As a result, even though we are just one month into the QE program, the first calls for tapering have already been heard. With deflation still a problem, we think that this call has come too soon, but at the same time acknowledge that the European economy is doing better than expected, enabling us to raise our growth outlook for the year to 1.75%. The US on the other hand faces some headwinds (oil, the dollar), pointing in the direction of a weak first quarter. The longer-term outlook remains positive though, as a low oil price boosts disposable income.

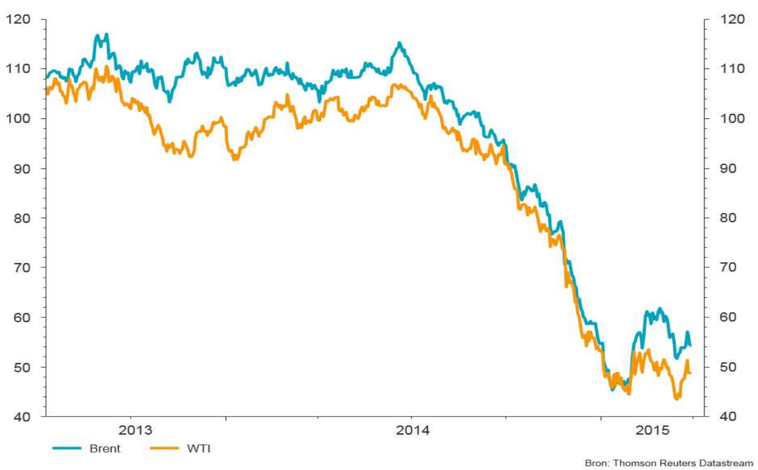
- As for financial markets, March offered more of the same of what we had seen during the first two months of 2015. Equities, real estate and emerging markets went up, bond returns were subdued, and commodities went down. We continue to stick to our overweight in longer-dated European bonds, as we expect the QE program to continue for the foreseeable future. Added to this, we have a small overweight position in equities and high yield, as we expect markets to drift higher, but with a higher level of underlying volatility.

United States

US personal consumption has been supporting growth



Oil prices may be heading even lower on account of Iran



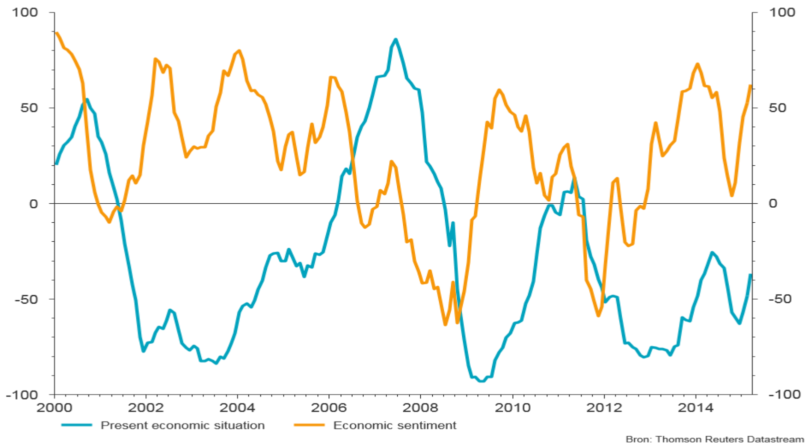
– After a disappointing fourth quarter of 2014 (a 2.2% growth rate, down from a robust 5% in the summer), the US economy will probably slow further in the first quarter of 2015, partly dollar, partly shale and partly weather related. Still, we expect the economy to strengthen from the first quarter onwards. Rising labor income and wealth will continue to boost personal consumption. The fall in durable goods orders and disappointing retail sales despite the oil price windfall suggests the recovery is weaker than expected, and we have lowered our growth projection for 2015 from 3.0% to 2.75%. The Fed will remain cautious and a first rate hike is now not expected before September 2015.

– The five permanent members of the UN Security Council and Germany [the so-called P5+1] seem on the brink of reaching a preliminary agreement with Iran. This is only a first step towards ending the 12-year standoff and Iran's economic isolation. As Iran has the world's fourth-largest oil reserves, any detente will gradually pave the way to even lower oil prices, which will offer added stimulus to the world economy. Rising tensions in Nigeria and Yemen have contributed to a recent hiccup in oil prices, but we do not think this will be permanent. The conflict in Yemen (0.2% of world oil production) will remain localized. In Nigeria, the coming apparently peaceful transfer of presidential power to the less divisive Muhammadu Buhari limits the risks for oil supply disruptions.

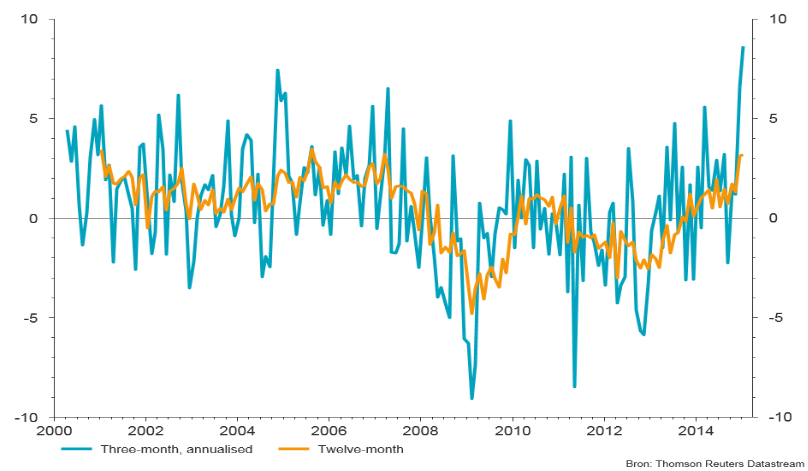
Economy

Europe

Euro Area ZEW survey shows sentiment is improving



Euro Area retail sales are racing ahead

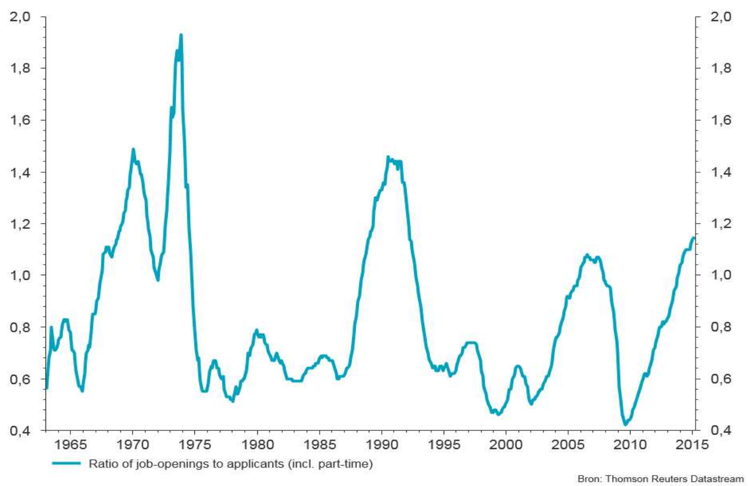


– The eventual unleashing of QE by the ECB has coincided with a remarkable shift in economic sentiment. The European economy is now clearly recovering, partly thanks to the lower oil price and the lower euro. As a consequence we have raised our forecast of Eurozone growth for 2015 from 1.5% towards 1.75%. Understandably, the question being raised is when the ECB will start to taper, as it is becoming less likely that the central bank will continue to buy EUR 60 billion in bonds per month until September 2016. As the ECB has indicated it wants to see "a continued adjustment in the path of inflation", inflationary developments will be crucial for the timing of tapering. With a current headline deflation rate of -0.1% we consider it unlikely that the ECB will taper this year. Tapering will probably become a topic for discussion in the fourth quarter.

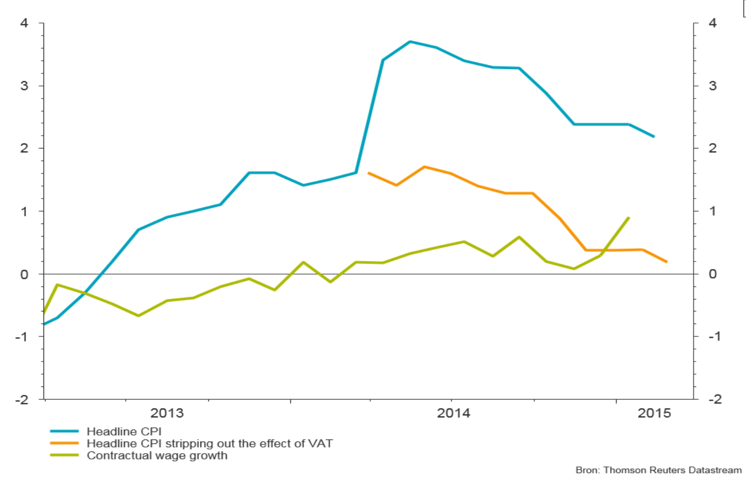
– The situation in Ukraine, which is teetering on the brink of default, will probably worsen. The Russian Federation shows no sign of lessening its attempts to destabilize the country. The EU is unlikely to lift sanctions. As for the other political worry, the standoff between Greece and its creditors continues. As a 'Grexit' would be not only be a disaster for the Greek economy and highly unpopular in Greece itself, but also a grave political defeat for the EU with possibly negative geopolitical implications, the logic of the situation still calls for some kind of agreement, even if only temporarily.

Japan

Japan: The job openings-to-applicants ratio shows that the labor market is tightening



Is the country again heading for deflation?



- The Japanese economy did disappoint at the beginning of this year. The weather-induced weak consumer spending in January was not corrected in February. Producer confidence disappointed as well: the March PMI fell sharply to 50.4, only marginally indicating expansion, the weakest growth rate since October 2014. Nevertheless, contractual wage growth is increasing and the rise in the job openings-to-applicants ratio points towards further labor market tightening. We expect therefore a strengthening of consumer demand in the coming months. We continue to stick to a forecast of about 1.0% growth in 2015.

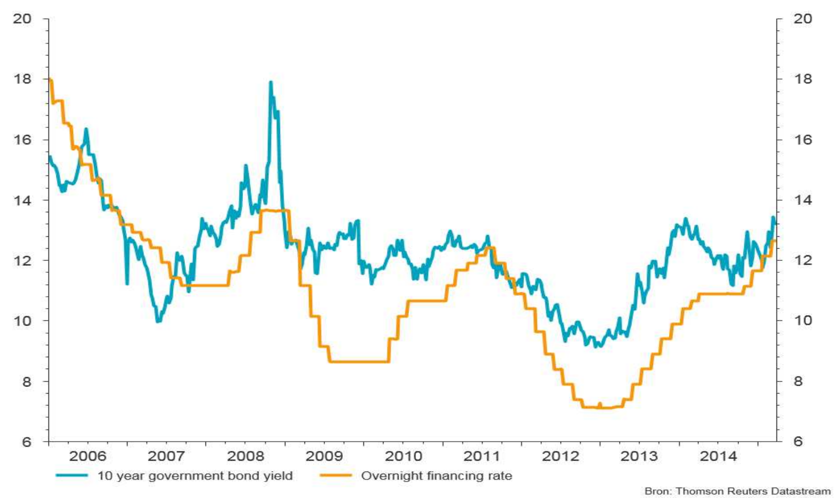
- The collapse in oil prices is driving the headline CPI towards deflation, when the effect of the VAT hike will drop out of the CPI figure in May. The governor of the Bank of Japan declared that there has been no change in the underlying trend in prices, predicting that inflation will pick up considerably in the second half of the fiscal year starting April 1 2015. The governor's remarks suggest that a further radicalization of the already very radical monetary policy won't come soon.

- Prime Minister Shinzo Abe insists that Japan is "firmly on track" to a primary budget surplus by 2020, despite the postponement of the VAT hike. He has promised concrete plans by the summer. These are certainly needed to convince skeptical Japanese corporations to invest at home.

Our BRICS highlight this month: Brazil

The Brazilian unemployment rate (% point change over 12 months)

Brazilian interest rates



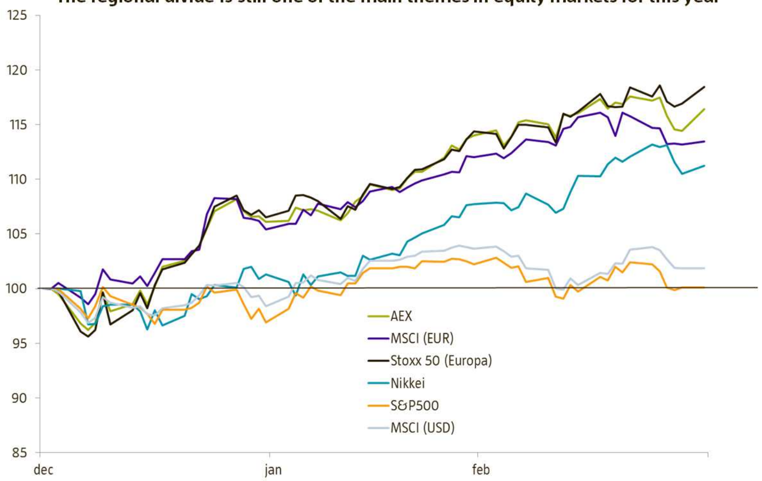
- Growth prospects for the Brazilian economy are weak after the re-election of the center-left president Dilma Rousseff. Structural reforms, needed to raise productivity and investments, are unlikely during her reign. Lower-trending commodity prices are hurting the Brazilian economy, which is currently in recession. Consensus expects a shallow recession in 2015 (0.5%) and a recovery to 1.5% growth in 2016, but this could turn out to be too optimistic. Still, it is much lower than the average 4% growth rate between 2002 and 2008.

- The current credit rating of Brazil is one notch away from junk (BBB- according to Standard & Poor's). With a relatively high government debt ratio of 66% of GDP, there is no room for fiscal stimulus. Neither is there room for monetary stimulus for the time being. Bond yields have risen towards 13%, as the central bank is hiking interest rates. Inflation is running higher than its annual inflation target of 4.5% plus or minus 2.0%. Inflation is of a cost-push nature, as wages have grown faster than GDP in the past ten years. An additional rate hike by 50 basis points is generally expected in the coming months.

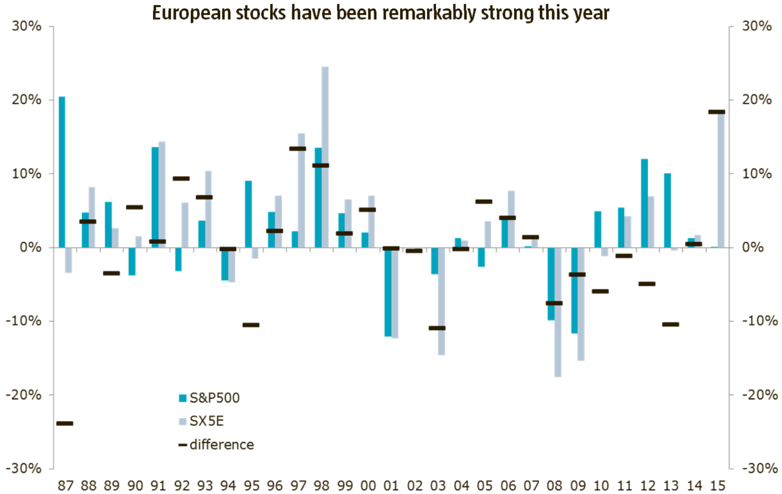
- Among emerging markets Brazil is one of the more heavily dependent economies on dollar-denominated external debt. Brazil is therefore especially vulnerable to a rise of interest rates in the US.

Equities (I)

The regional divide is still one of the main themes in equity markets for this year



European stocks have been remarkably strong this year



- Ask investors across the globe on how they view 2015 from an equity perspective and you are bound to get some pretty diverging responses. In Europe and Japan, the reactions will be generally positive, as both the European Stoxx (+18%), as well as the Nikkei (+11%) have yielded impressive double-digit returns in the year to date. Improving economic prospects, higher earnings and the (aggressive) support of central banks all helped to push stocks higher in these regions. For European investors this positive feeling even extends beyond European borders, as non-euro investments also got a boost from the weakening euro. An unhedged investment in the US Nasdaq for example has yielded 15% in the year to date, which is mostly the reflection of the decline of the euro. Not surprisingly, some investors are wondering how long these good times will last.

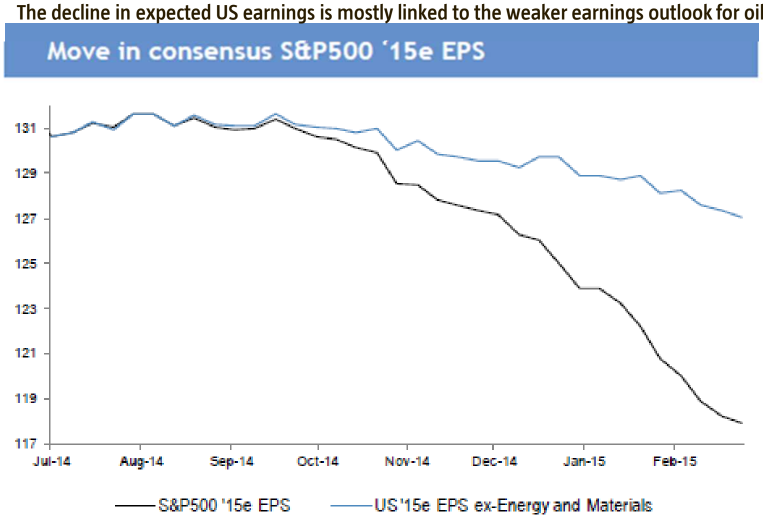
- The reactions to this will be quite different on the other side of the pond though. To take the Nasdaq as an example, the US investor is currently looking at a +3% return in the year to date, while the S&P 500 has so far not been able to decisively break away from the 0% level. Also, because of the strength of the dollar, US investors have not benefited at all from the strong rally seen in Europe, adding to the 'is this it?' feeling that currently prevails in US markets. In fact, based on data going back to 1987, this is the strongest first quarter divergence in favor of Europe on record (see chart). Not surprisingly, flows >>

Equities (II)

Positioning has worked in favor of European stocks

Chart 24: Relative positioning: US vs Eurozone (ppt)

The decline in expected US earnings is mostly linked to the weaker earnings outlook for oil



Source: IBES

across the various regions are also showing a substantial divergence.

- So is the weakness in US stocks something to be worried about? When we addressed this question back in January we came to the conclusion that it was not, an assessment that we still stick to. US stocks have been hit by a number of factors, including the strong dollar, the collapse of the oil price, high valuations and the Fed moving in the direction of a first rate hike. The first of these two factors have driven earnings estimates sharply down, with earnings per share expected to rise by less than 2% in 2015. This sounds weak, but it should be pointed out that this is mostly related to the oil sector: excluding oil, earnings per share are expected to rise by roughly 9%. In other words, focusing too much on the headline number may lead to the wrong conclusion that the US is close to experiencing an earnings recession, which it is not.

- As we pointed out last month, 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, on which we are not too negative at this point. Short term, the negative element of the oil price decline will dominate (more so in the US and UK than elsewhere), but longer term it is a net positive for the better part of the world. We have upped our growth expectations for the Eurozone. Looking at >>

Equities (III)

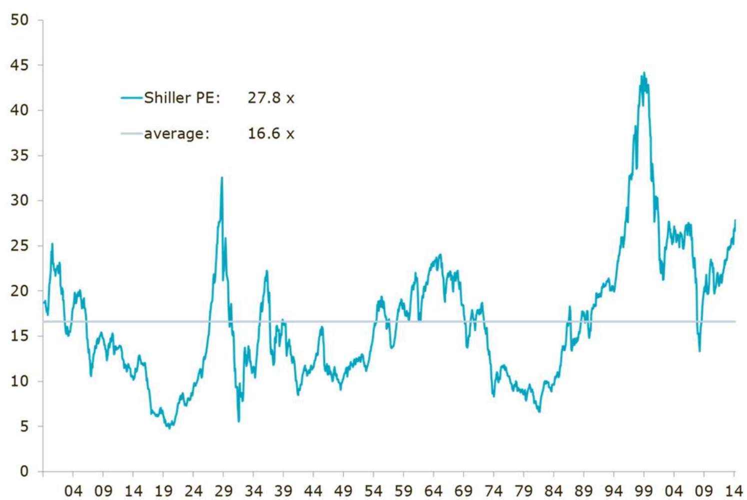
Expected earnings are looking realistic for a change

EPS growth (%)

	2013	2014	*2015e*	*2016e*
United States	8.4	5.2	*1.9*	*13.5*
Europe ex UK	-2.5	3.2	*9.8*	*12.6*
Pan Europe	-5.4	0.7	*3.2*	*12.8*
United Kingdom	-9.9	-3.2	*-8.1*	*13.3*
Japan	74.6	8.6	*14.5*	*8.4*
Developed markets	6.5	4.8	*2.6*	*12.7*
Asia x Japan	7.8	5.6	*10.3*	*10.5*
Latin America	5.4	-12.9	*10.6*	*15.6*
Emerging Markets	19.3	-2.6	*9.1*	*11.7*
Global	8.1	3.7	*3.5*	*12.5*

source: credit suisse

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

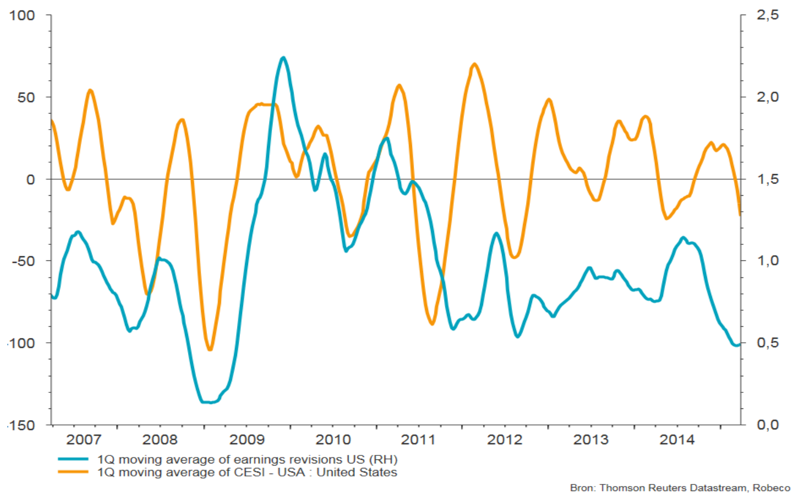


earnings and taking the negative oil effect into account, the expected EPS of only 3.5% for the MSCI World in 2015 looks a lot more realistic than it normally does around this time of the year.

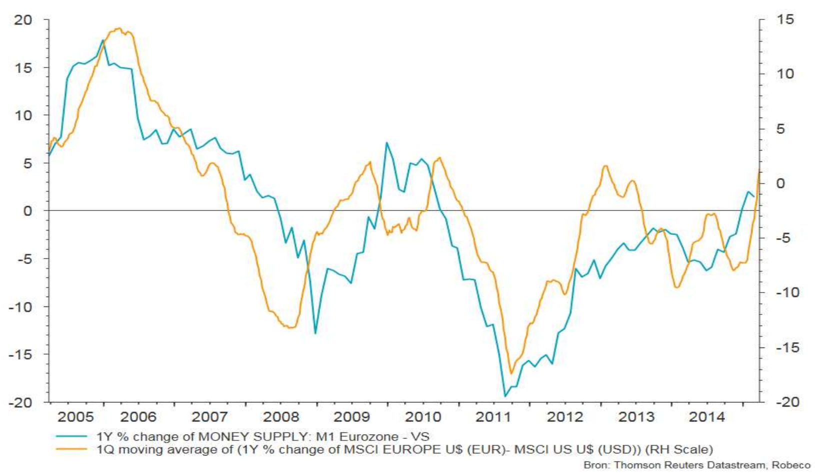
– A second factor determining the fate of stocks is valuation. Stocks are not cheap. Our preferred valuation matrix continues to be the cyclical adjusted PE ratio, a.k.a. the Shiller PE. According to this measure, stocks are trading close to 28 times past earnings, a level only seen during the 'roaring 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. European and most Asian markets have lower valuations, making stocks less expensive overall. With liquidity still ample, companies still driving towards stock buybacks and the search for yield remaining 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.

Equities: regional split in developed markets (I)

US earnings revisions will improve when the US soft patch starts to fade



Divergence in monetary policy coincides with relative equity performance in local currencies

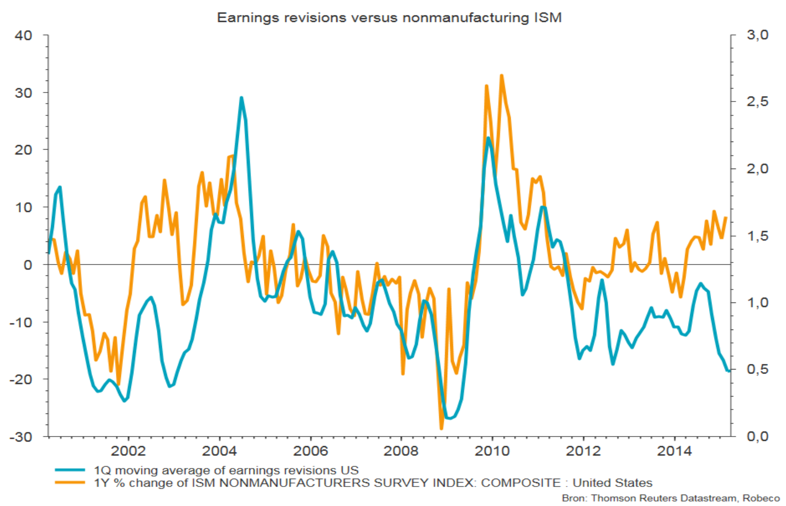


- For the second month in a row, macro data in the US surprised to the downside, while Europe surprised to the upside and the Pacific region outperformed other developed markets. Recent US macroeconomic data like the Philly Fed, durable goods orders and retails sales all disappointed. The strong dollar, the struggling oil sector and (albeit moderately) rising wages have created headwinds for US corporate earnings. In the Eurozone, cyclical factors, the depreciation of the euro, the decline in oil prices (although this is more limited in euro terms) and lower unit labor costs all help boost producer and consumer confidence.

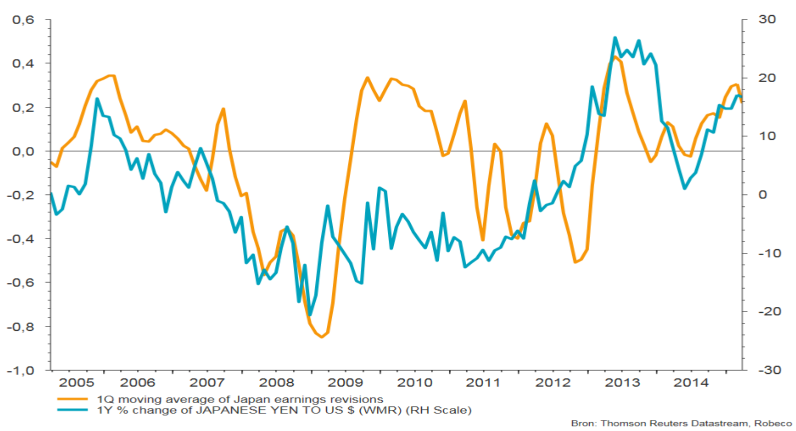
- Diverging monetary policy remains a key driver behind returns in local currency. Relative performance of European stocks closely tracks the relative money supply by central banks. As the ECB is expected to continue its expansionary policy versus the US, the European equity perspective in local currency is benign. However, measured in dollars, the performance picture is quite different. We expect the dollar rally to continue after the breather it has taken. Although the latest dovish Fed pronouncements brought down rate hike expectations in the market, the first hike is expected in Q3, as the soft patch in the US will prove to be temporary. In Japan, stock performance is expected to remain strong as the BOJ will stay in the easing mode, given the recent weakness in inflation.

Equities: regional split developed markets (II)

Divergence between services ISM and earnings revisions: dollar and oil at play



The weaker yen coincides with upward earnings revisions Japan



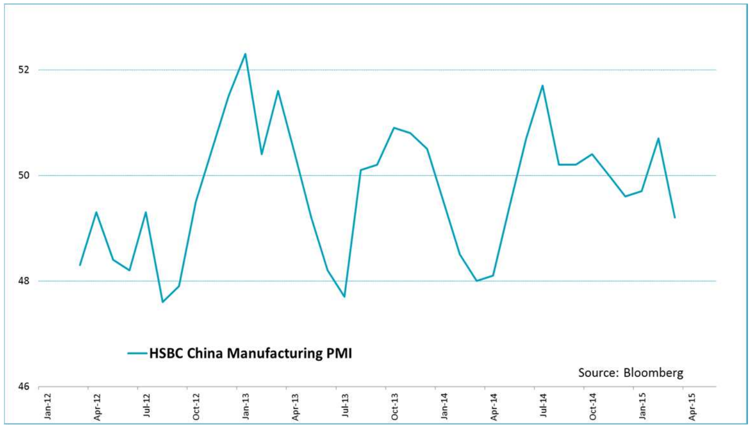
- Valuations in Europe have risen in the recent rally, as the sentiment around European equities remains strongly upbeat. Valuations have now risen above historical averages relative to the US on a 12-month forward price- to earnings metric, leaving not much upside left from a valuation point of view. As a rule though, valuation is never a good market-timing metric. The more dovish tone by the Fed and the expected delay in the rate hike expectations makes stretched US valuations less of a driver in the near term.

- Relative momentum is currently strongest for the Pacific region within developed markets, spurred by stories about additional easing by China. Also, the BOJ will be pressured to keep pace with its QE program as the rate of inflation, when corrected for the VAT hike impact last year, is not consistent with the central bank's inflation objective. In addition, it seems Japan has the biggest incentive for upward surprises on the monetary front within developed markets, even though we do not expect it in the short run. Although Europe also profits from lower oil prices and expected depreciation versus the dollar, we think Japan has the stronger cards to profit from these developments, as geopolitical elements are less precarious around the Pacific. We prefer an overweight to Japan, and we retain our neutral stance towards the US and Europe.

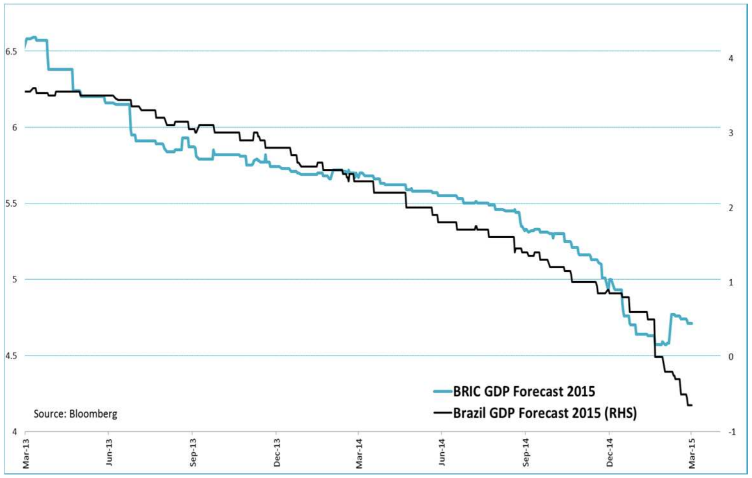
Equities: Emerging vs Developed (I)

Equities

China Manufacturing PMI is back below 50



Brazil's GDP growth forecast

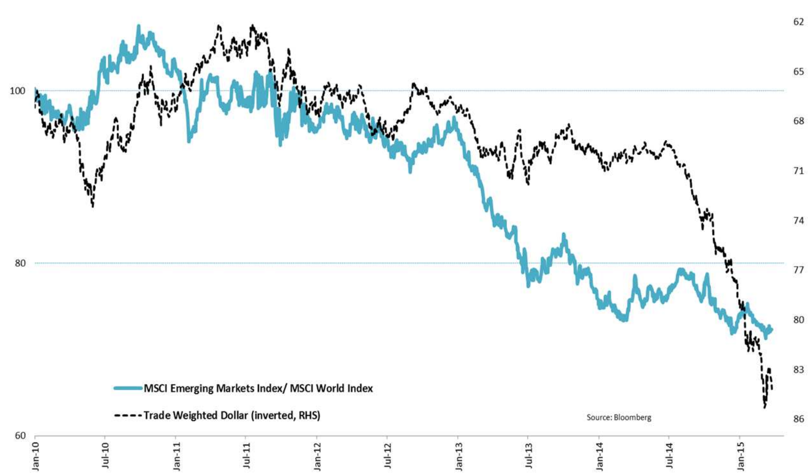


- The macro outlook for emerging countries remains weak. China, the world's second-largest economy, is slowing, and probably at a faster pace than the government has anticipated. Chinese business confidence, as measured by HSBC, fell back below 50 again in March. Other important economic indicators such as electricity production and rail freight also point to lower economic growth. Meanwhile, the Chinese property market is cooling off, after being a steady source of income for many (wealthy) Chinese in the years before. In all but one of the 70 big cities that report house price data, house prices have come down compared to a year ago.

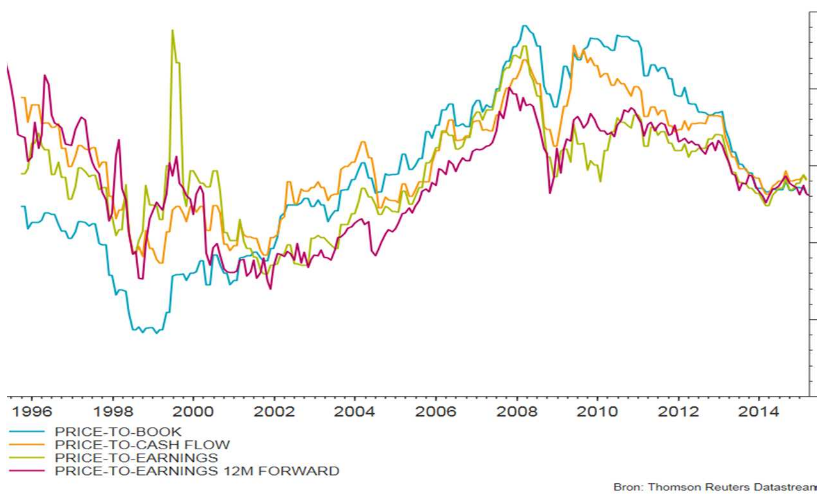
- Other emerging markets are struggling as well. Russia has been mentioned many times before here, as sanctions that followed the Ukraine dispute and rapidly falling oil prices have pushed the country into a recession. But Brazil's economy, which is also heavily dependent on commodity exports, will probably shrink this year as well. Economists surveyed by Bloomberg expect Brazilian GDP growth to equal -0.5% this year, which could easily turn out to be too optimistic. A massive depreciation of the Brazilian real has pushed inflation rates up, forcing Brazil's central bank into the awkward position of having to raise interest rates.

Equities: Emerging vs Developed (II)

The strength of the US dollar remains an important risk



The valuation of emerging markets is attractive



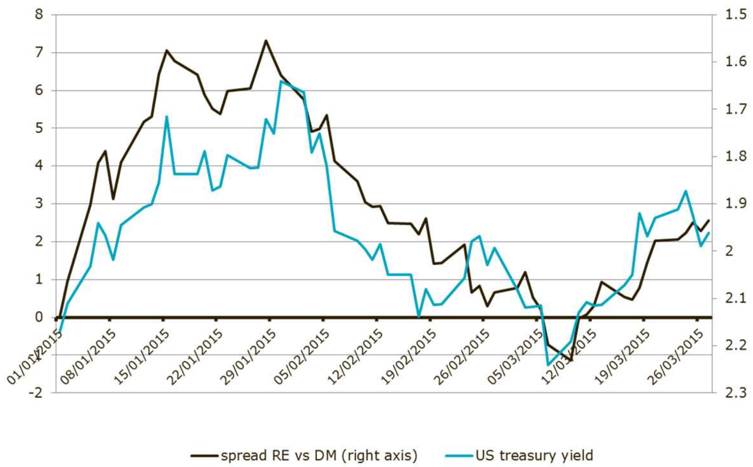
- After taking a short breather the US dollar has started to appreciate again. The Fed delivered a dovish statement in which expectations about future rate hikes were lowered. Still, the Fed remains one of the few central banks that has skewed towards tightening monetary policy, instead of loosening. Historically, a stronger US dollar has been accompanied by an underperformance of emerging markets.

- So far the stronger US dollar has only been partly mimicked by the relative performance of emerging markets. This could have something to do with the stimulative stance of many other central banks in the world. On a global level the Fed hiking rates cautiously doesn't mean an overall tightening of financial conditions. That said, by far the biggest chunk of foreign emerging company and government debt is denominated in USD.

- Emerging market valuations remains attractive, especially from a more recent point of view. Emerging stocks are now the cheapest in over 10 years. However, from a longer-term perspective the discount is less impressive. On account of the weak economic and earnings outlook, we remain underweight emerging market equities in favor of developed market equities.

Real estate

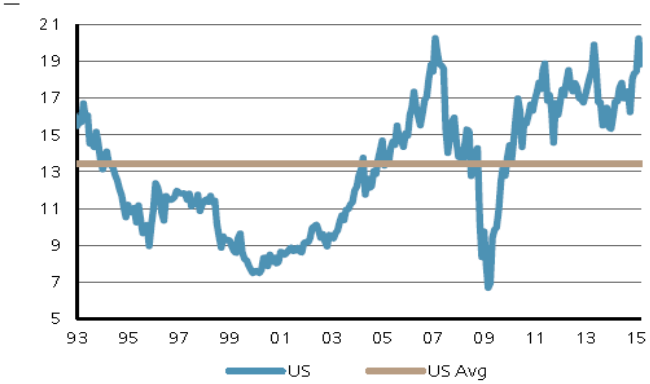
'Where the US Treasury rate goes, so goes global real estate'



Source: Bloomberg, Robeco

Valuation of US real estate is above average (but who cares right now?)

Figure 129: FFO Multiple



Source: Worldscope, I/B/E/S, DataStream, UBS estimates, as of 27 Feb 2015.

- 'Where the US Treasury rate goes, so goes global real estate' is in one line the summary of the current phase that the real estate market is in. Real estate relative to equities goes up when the interest rate falls, and vice versa. During March, the US Treasury rate declined (see the reverse axis in the graph), which pushed global real estate up by 5% in US dollars. By comparison, global equities rose by approximately half of that.

- The whole investment community agrees there will be an interest rate hike this year, but is unsure about the timing of it. Given the strong correlation between the US Treasury rate and global real estate, it seems wise to be neutral for now. When the interest rate is definitely heading north, an underweight position in real estate seems appropriate.

- Meanwhile, the valuation of real estate is stretched, to put it mildly. Real estate in the US is expensive compared to equities 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 are keeping our neutral position for real estate.

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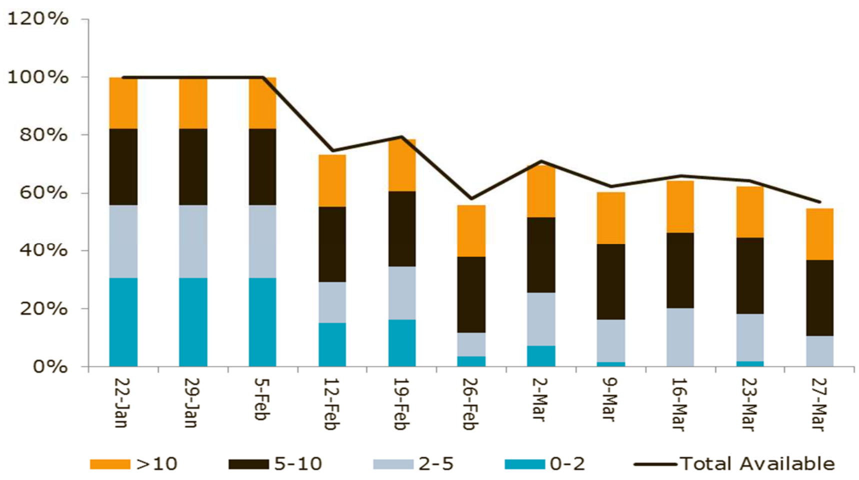
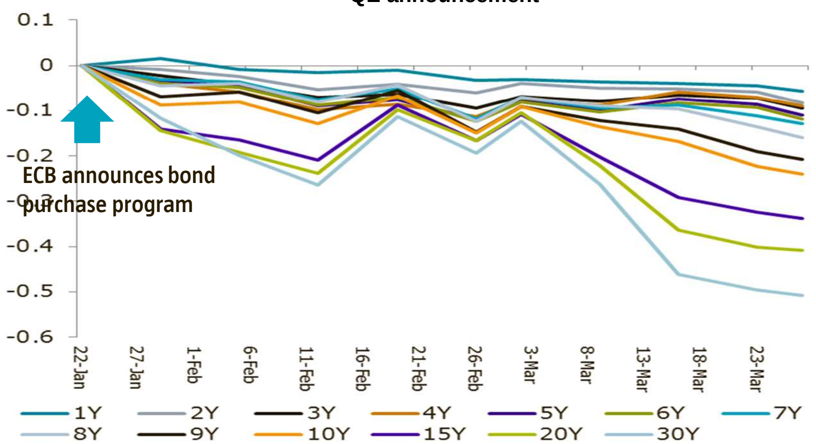
AAA bonds (I)

Fixed Income

A shrinking supply of bonds with a yield above -20bp



Downward pressure on rates across different tenures since the ECB's QE announcement



– In the first weeks of buying bonds, the ECB didn't disappoint the market. Based on first indications, the ECB is on track with its bond purchase program. Yields across the board reacted as expected, with 10-year German bonds dropping to new all-time lows during March.

– With the ECB only allowed to buy government bonds that have a yield in excess of minus 20 basis points, it means that lower yields automatically limit the pool of bonds the ECB can buy from. From the day the ECB announced its intentions (22 January) the availability of eligible bonds started to decrease. Currently no German Treasury bond with a maturity up to 2 years is eligible to be purchased, as they all yield less then -20bp. We have no reason to assume that the purchasing program will be stopped before September 2016. We do however see that execution of the policy might be complicated as the pool of eligible bonds decreases rapidly.

– The ECB has to ensure that implementation of the bond purchasing program is as transparent as possible, in line with the way the Fed and the BOE acted when they were executing their QE programs. There should be no reason for the market to doubt the policy.

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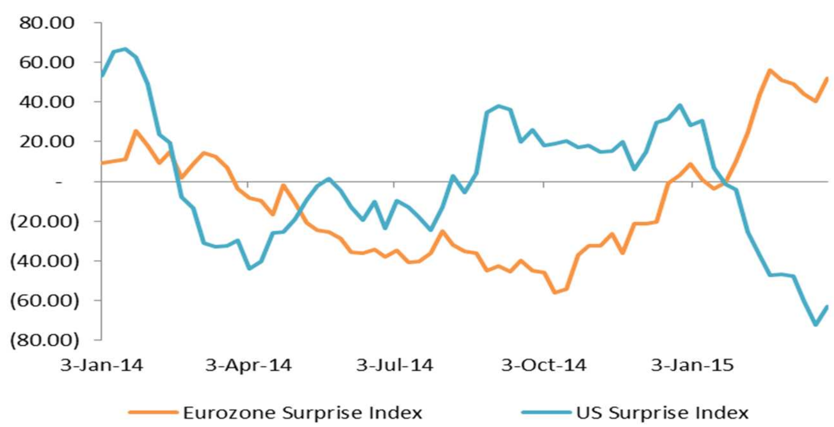
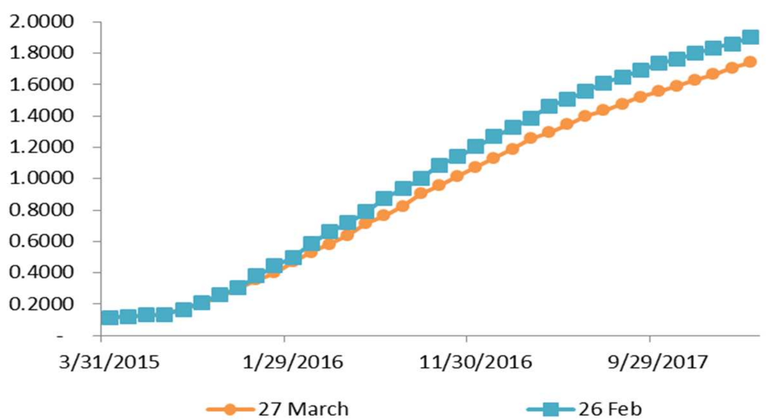
AAA Bonds(II)

Eurozone data keep surprising while the US disappoints



Markets listened to the Fed and lowered rate expectation compared to last month



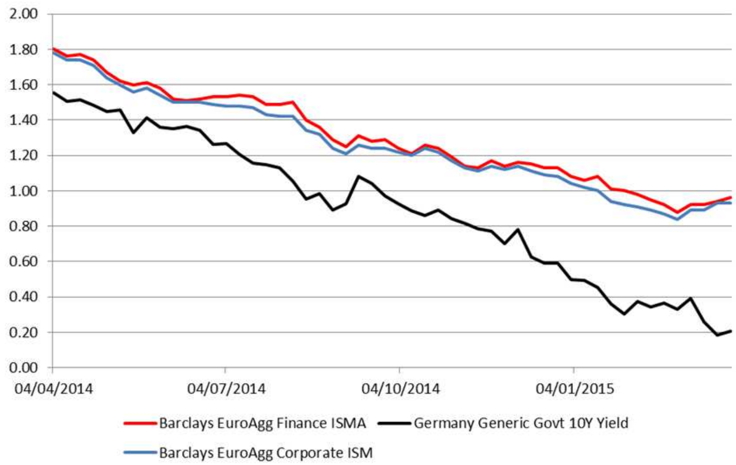
- While transparency is the name of the game for the ECB to ensure that QE is effective, the Fed seems to be moving in the opposite direction. Saying goodbye to forward guidance by definition increases policy uncertainty. The way this plays out was already noticeable at the last meeting. While most participants were preparing for an early hike, the message that came from the Fed was relatively dovish. 'Yes, the job market is improving, but all is not well' seems to be the message from the Fed. This prompted the market to adjust its rate hike expectations, pushing bond prices higher and yields lower. The consensus still expects the Fed to raise rates this year.

- While US data has disappointed, Eurozone data has been surprising to the upside. We continue to see the improving growth story as one of the bigger risks for a long bond position, as this might open the door for a less coherent ECB, which could ultimately lead to speculation over the length of the buying program. Up until now though, ECB President Mario Draghi has been relatively successful in keeping the ranks closed within the ECB.

- For now we remain comfortable with our recommendation to be overweight European bonds. We continue to prefer longer-dated bonds and non-core.

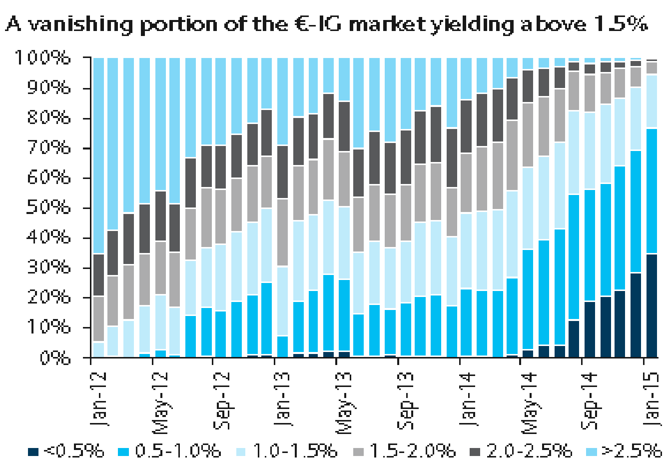
Investment Grade Credits (I)

European credit yields and the Bund yield



Source: Bloomberg, Robeco

Yields on IG credits continue to decline



Note: Benchmark indices, ex. Subordinated. Source: Barclays Research

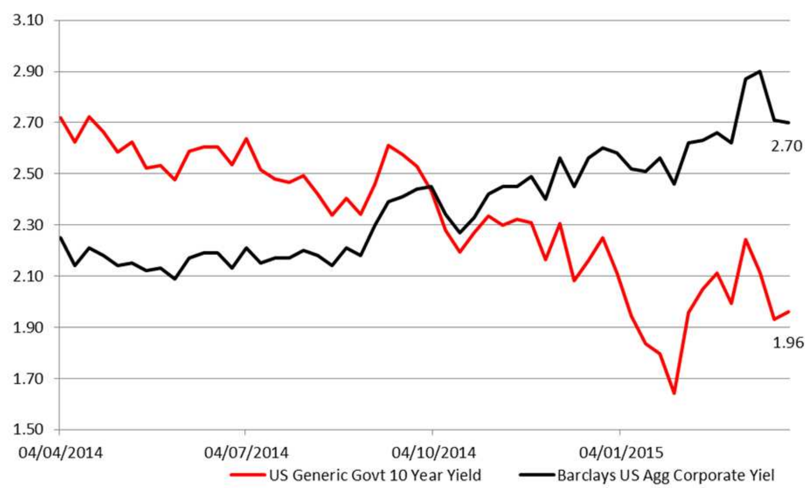
- Spreads on European credits widened sharply last month, which for a small part was due to an increasing risk premium on credit bonds. The German government bond yield fell another 17 bps in the second week of March after the ECB started its bond-buying program. That explained about half of the widening of European credit bonds this month, which was ultimately 24bps. The European credit yield ended 11 bps higher at 93 bps.

- Currently, the ECB does not intend to buy corporate bonds, but as we saw, its actions have certainly have an impact on corporate bond pricing. As the scheduled government bond buying program of the ECB is high compared to the total market, the central bank is pushing investors towards the investment grade bond market. The effect is that yields, especially for short maturity European credits, are being pushed down. It's very hard to find a credit with a yield of more than 1.5%. Issuance of new European credits has come down, but this has partly been offset by issuance of US corporates denominated in euros.

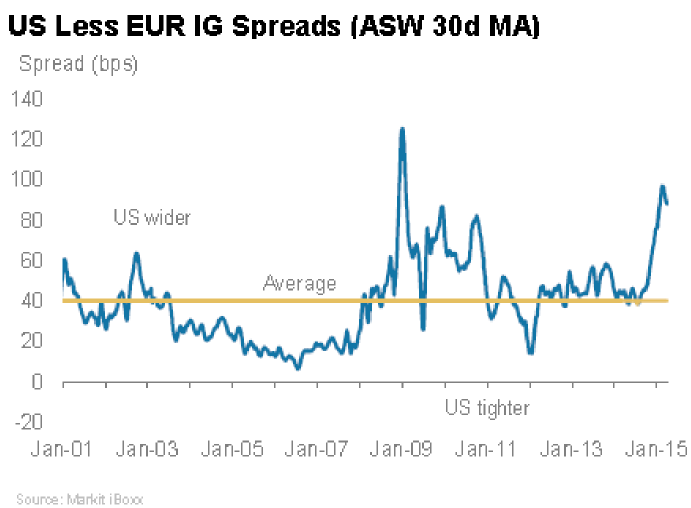
- Although spreads widened a little bit last month, we still think the credit market offers too-low yields. The pressure on the yields will continue as long as the ECB keeps buying. So, we keep our underweight position in European credits.

Investment Grade Credits (II)

The US credit spread widened last month



The spread between US and European credits tightened, but are still at a historically high level



- European investors have stepped up purchases of US corporate bonds, whose yields are relatively more attractive compared to those available in Europe. About USD 50 bln of US corporate debt was bought in the last six months, which historically is an extremely high level. US spreads have widened for several months. Yields are now around 2.70% in USD, so with a EUR/USD exchange rate at 1.08 there's still an interesting yield gap for European investors.

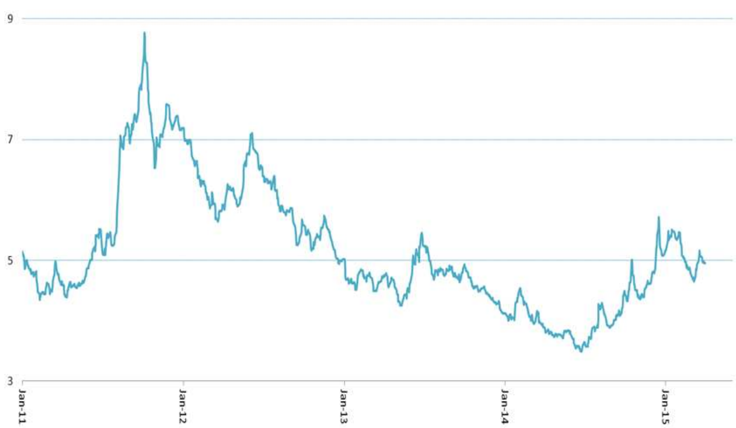
- A rate hike would hurt US credit performance, but the indication is that this will not occur in the coming months. On the macro side, recent data suggest that the US economy is slowing down a bit, but we expect a limited impact from that side for the time being. For now, ECB action and its impact on the global credit fund flows is more important . Overall, we still expect that spreads between US and European credits will tighten a little in the coming period.

- Keeping the search-for-yield mantra in mind, US credits are still an alternative to their European counterparts, though investors should be aware of the slightly higher risk profile of US credits, and the currency risk.

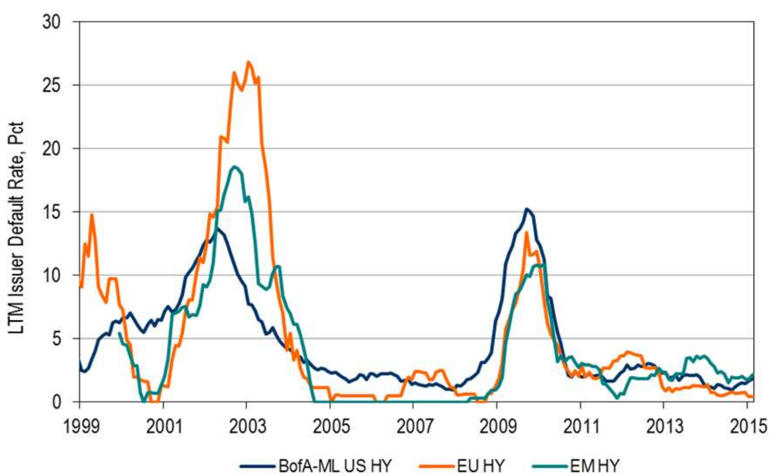
Fixed Income

High Yield (I)

High yield spreads



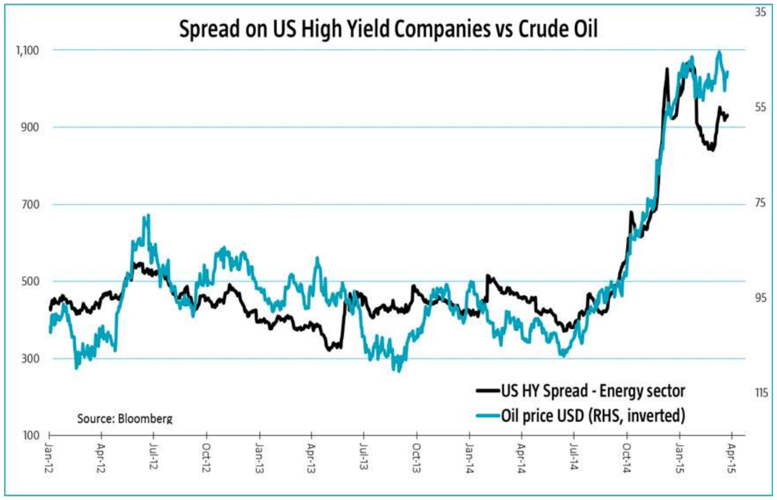
Default rates set to remain low



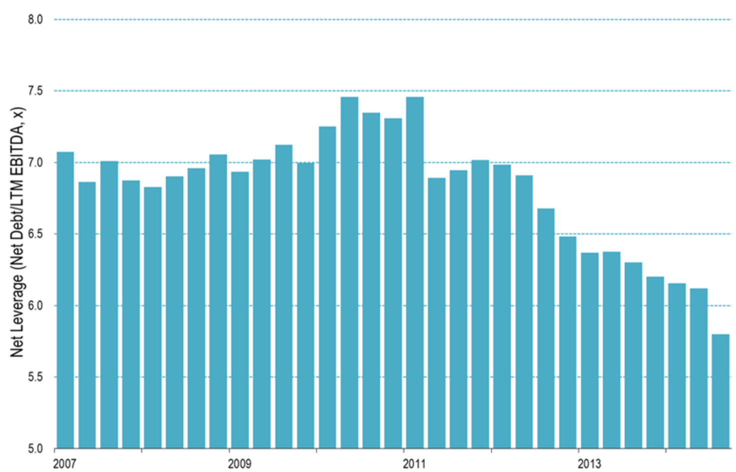
- After a very strong February, the return on high yield bonds was less impressive in March, especially in euro terms. The Global High Yield Index returned -0.1%. The spread against AAA government bonds widened by 20 basis points.
- High yield companies continue to benefit from improving economic circumstances. Even though the US experienced a bit of a soft spot in the first quarter, we expect growth to pick up again from now. In Europe, economic data have surprised on the upside, as a lower euro and falling oil prices start to take effect.
- The reasonable outlook for the two biggest high yield markets implies that the default rate will continue to stay low. In fact, default rates are expected to come down a little bit further before going up again. In the US, default rates could bottom out at 1% in the second quarter before slowly moving back up to 2%, which is still a very low level from an historical viewpoint.
- In recent months, US high yield has become more attractive. Yields and spreads are relatively high and the ratio of upgrades and downgrades looks more favorable in the US than in Europe.

High Yield (II)

Leverage ratios are increasing...



... but effective interest costs are falling



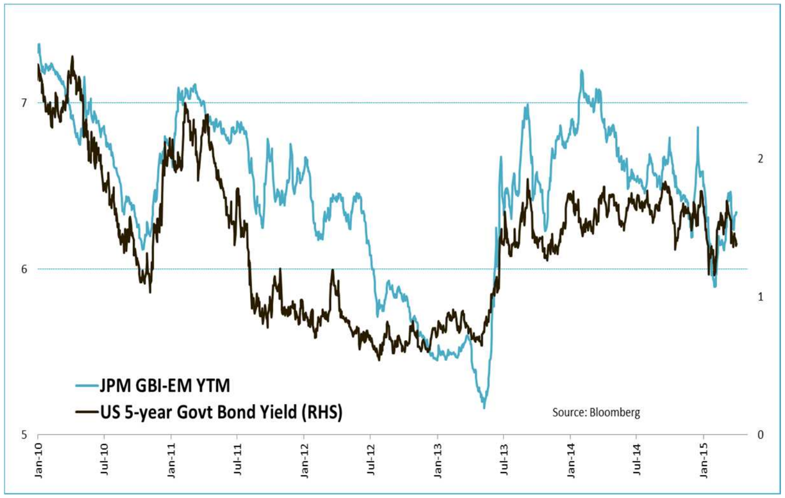
– Factors that may impact high yield returns are worth mentioning. First, due to the increased weight of US energy companies in the global index, oil prices have become more important. The chart on the left shows that spreads on energy companies have widened considerably as oil prices have collapsed. However, as we have mentioned before, investors got a bit carried away and we see some value here. That said, a further decline in oil prices is not unthinkable, which would impact this segment within the high yield universe.

– Second, although a first rate hike by the Fed would lift short-term rates, this isn't necessarily bad news for high yield bonds. Hiking cycles have traditionally been accompanied by better economic prospects, which make high yield bonds more attractive. Third, over the last couple of years the leverage ratio of high yield companies has steadily increased, though this is less troublesome when current interest rates are taken into account. Interest costs have actually gone down as bond yields have fallen sharply, and we don't see them going up rapidly anytime soon.

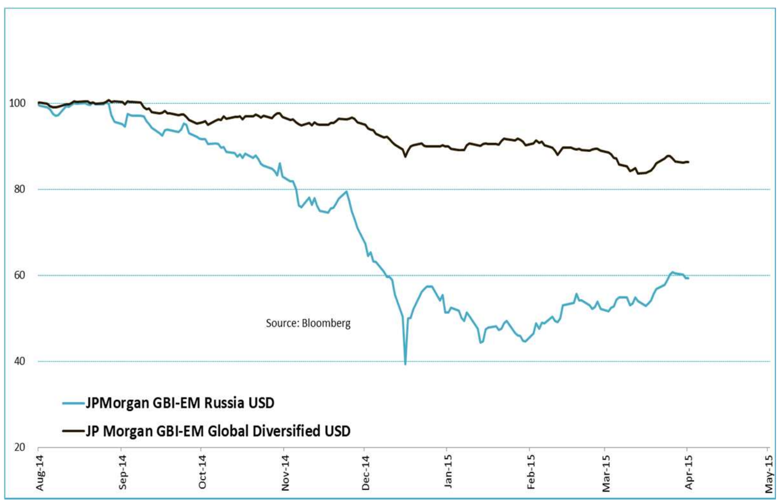
– We continue to be overweight high yield bonds. The asset class offers an attractive valuation against government bonds, credits and cash.

Emerging Market Debt (I)

Yield-to-maturity ratios of emerging market debt



Russian local currency bond performance

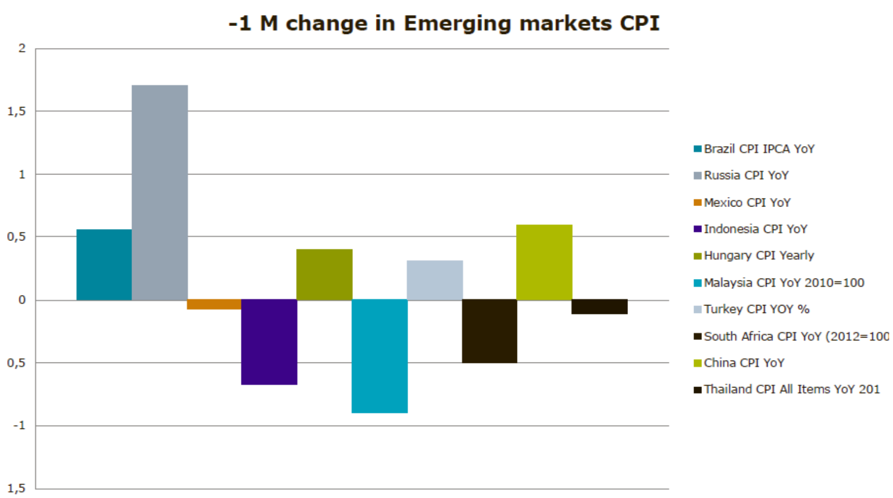


- Spreads on emerging market debt (EMD) widened a modest 20 basis points over the last month. Still, spreads are below the levels that specific risk proxies in emerging markets suggest. However, as we have noted before, currency movements dominate the return composition of EMD in local currency. The exchange rates of emerging markets are still challenged by the stronger dollar, the sluggish oil price rebound, a slowing China and the anticipation of a Fed rate hike later in the year. The recent dovish tone by the Fed, removing 'patience' in its statements but not showing signs of impatience either, could cap emerging market currency losses in the coming months.

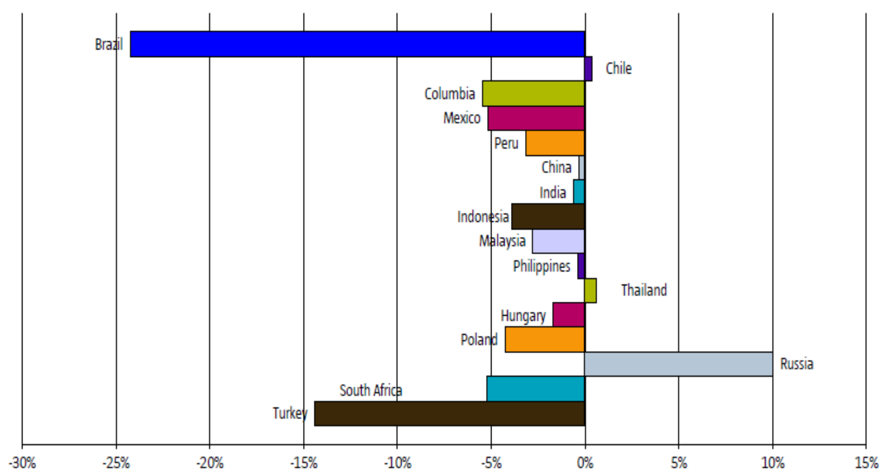
- Two countries showed a striking divergence in performance: Russia and Brazil. Russian local currency bonds stabilized further as oil prices rebounded and no new sanctions were inflicted. However, it is not likely that current Western sanctions will be lifted in the near term. In Brazil, developments have been less benign as President Dilma Rousseff has announced austerity measures which will likely push Brazil further into a cyclical downturn. Given low productivity, subdued investment and stubborn inflation, Brazil has a lot of homework to do. For both Russia and Brazil, a deal with Iran about its nuclear program is net bearish as this exercises further downward pressure on oil prices.

Emerging Market Debt (II)

1-month change in inflation



1-month change in emerging market currencies



- The disinflationary trend in emerging markets continued last month, except for Russia and Brazil. Russia seems to have the least room for easing monetary policy as the country is still suffering from capital flight and Western sanctions. The outlook for Brazilian local government bonds remains poor given that cost-push inflation pressures are not likely to vanish. Lower commodity prices (partly due to the Chinese slowdown) will also likely trigger further downward inflation surprises in emerging markets, offering room to loosen monetary policy. Indonesia, Turkey and Peru have already lowered rates this year and more rate cuts are expected.

- Emerging market currencies are likely to remain under pressure, especially against the US dollar. Rallies in the US currency tend to last quite a while, and the recent weakening in dollar momentum looks to have already passed. While we should take into account the fact that ultimately, returns are measured in euros, the emerging currencies could also weaken against the euro, especially given the better fundamentals in the euro area. Current accounts are improving slightly this and next year, but they remain negative for most countries. Despite external challenges and domestic problems in some cases, the yield on EMD is relatively high versus overvalued developed market fixed income categories. The disinflationary trend could further compress yields. We stay neutral on emerging market debt.

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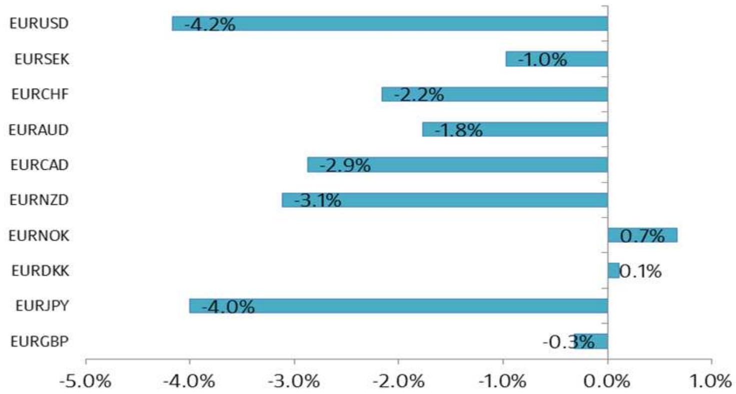
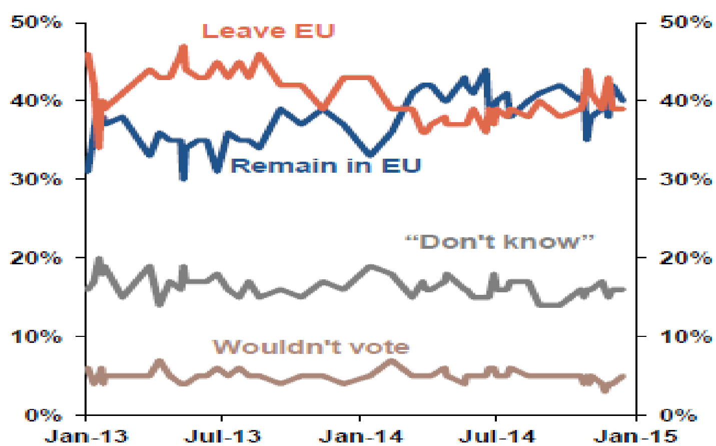
FX (I)

The euro is still depreciating against most G-10 currencies



Elections are starting to weigh on sterling



Source Societe Generale

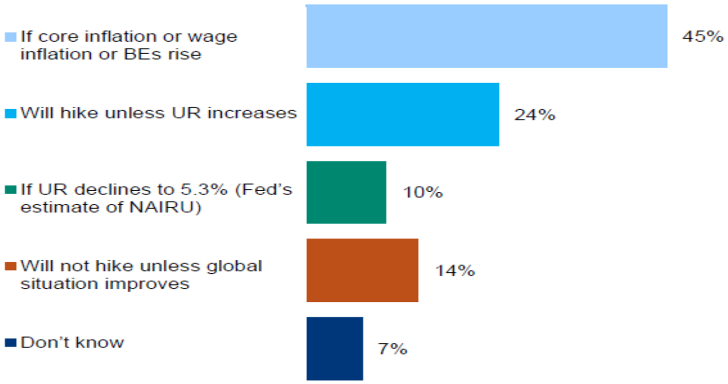
- In March the euro stayed under pressure against most currencies . It only managed to strengthen marginally against the Norwegian krona and the British pound. The market for sterling seems to be getting slightly more nervous as the UK general election approaches. This leads to a willingness to hold less sterling even though UK data have generally been improving.

- In March, EUR/USD reached 1.049, a level last seen in 2002. Some upwards pressure started to build during the month, so what triggered this reversal? It was definitely not the ECB. As we mentioned last month we actually think that the ECB is becoming less relevant for the euro at the moment. Unless the current economic strength withers, the size and direction of monetary policy are set until September 2016. This is not our central scenario, which means that the ECB has become less of a driving force for the euro.

- We therefore continue to see US monetary policy as being the most important driver for EUR/USD in the coming period. With forward guidance coming to an end, the volatility will increase around data points, as the market weighs the importance of each one.

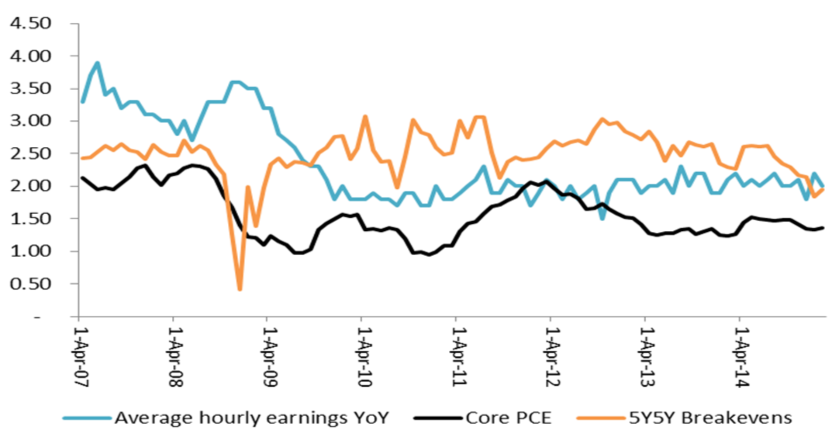
FX (II)

What is a necessary condition for the Fed to hike in June?



Source: BofA Merrill Lynch Global Research

Money is flowing out of Japan



- The importance of data for future rate hikes became apparent at the last Fed meeting. The market believed ahead of it that good job numbers validated an early lift off. But the Fed message was dovish, signaling that employment figures alone are not a sufficient condition to hike rates. A general improvement of the numbers therefore seems necessary. A survey of investors revealed that inflation is considered to be the most important driver for future Fed policy. Currently inflation indicators are not flashing warning signs. so we think that the Fed can hold out for a while longer.

- We continue to believe that QE will continue in Japan, and think that in time, a fresh round is probable. However, due to upcoming regional elections we will need to wait a while longer for it. Portfolio outflows also remain important as an indication that locals are reacting to QE.

- We continue to believe that the most likely path for the US dollar is up. Fed policy will continue to be an important driver, though the timing and speed of the tightening cycle are uncertain. We continue to look for opportunities to add a long dollar positions, either by increasing our current long USD/JPY position or by entering an long EUR/USD position.

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