ROBECO

Monthly Outlook
Bernanke discovers his inner dove

In this issue

Financial Markets Research:
Léon Cornelissen
Ronald Doeswijk
Peter van der Welle

Highlights

- The Fed has made a considerable effort in its communications to discern between unwinding unconventional policy measures and maintaining its accommodative stance on interest rate policy. Fed Chairman Ben Bernanke struck a more dovish tone, but at the same time did not give away the progress made in preparing the market for tapering. Japanese Prime Minister Shinzō Abe has secured his mandate for 'Abenomics' by winning the Senate elections. The euro zone economy is improving, as manufacturing and export activity increased, and political tensions in the periphery waned. In general, economic news from the BRIC countries point towards a deceleration.

- We maintain our positive view on equities. Interest rates will be artificially depressed for the foreseeable future. We do not expect a significant improvement in the global economy in the months ahead. Moderate economic growth results in an attractive macroeconomic environment.

- We are neutral on real estate, which outperformed equities when interest rates and interest rate spreads were falling. The interest rate environment is now at best neutral for real estate. Valuations do not provide support. Therefore, we think that the outlook for equities is more attractive than for real estate.

- We hold on to our positive view on high yield. 'Covenant lite' issuance has reached an all-time high, which is a negative. However, as we will move from below-trend growth to trend or above trend in the years ahead, we expect low default rates. Consequently, this factor is likely to come into play at a later stage. In the meantime, spreads remain attractive and, contrary to investment grade credits, still offer the potential for a reasonable absolute total return.

- Within equities, we still favor North America. Its economic performance is good compared to other regions; earnings revisions and momentum underline this. We remain negative on emerging markets, where we do not anticipate an improvement in economic data. Earnings revisions are also bad, though we believe the downward potential relative to other regions to be limited from here. Otherwise, valuations should start to support the market.

Macroeconomic view

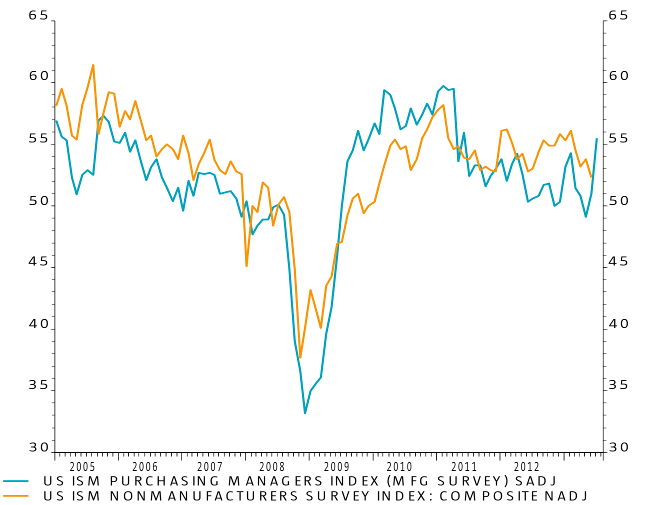
Global economy

In July, long yields on ten-year US Treasuries stabilized and moved range-bound between 2.5% and 2.75%, after the Fed tempered its language on the unwinding of quantitative easing. In its communications, Bernanke made more dovish statements about the risks of higher mortgage rates, the benign inflationary environment and underlying weaknesses in the labor market. In Japan, Abe strengthened his position with a victory for his LDP in the Senate elections, but prioritizing his nationalistic agenda could be a threat to economic progress. Ten-year yields have eased somewhat compared to June, remaining just below 0.8% as the yen rose against the USD, reaching the 98 level at the end of July. The economy is showing signs of improvement as the CPI rose 0.4% in June, although this does not necessarily mean the end of deflation as the price rises were contained within the energy sector. The euro zone economy has stabilized further with the euro zone composite at 50.4. Political tensions in Greece and Portugal waned, as Greece was granted payment of the next tranche by the Troika and Portugal avoided early elections. China showed more indications of a slowdown in its economy, with the authorities increasingly vocal about policy measures they believe are necessary to navigate a complex internal and external environment. We hold the view that the Chinese economy will struggle to achieve its 7.5% growth target. In general, other BRIC countries are experiencing headwinds, with Brazil hiking rates again to bring down inflation and defend its currency.

North America

The US economy remains on track to start scaling down quantitative easing before the end of this year. The 1.7% rise in second-quarter GDP on an annualized basis showed the sequestration effect on activity to be modest. US consumer confidence rose to its highest level since the onset of the financial crisis, despite still-moderate wage growth of 2.2% in June. The rise in non-farm payrolls of 162,000 was below the average of 200,000 new jobs seen in previous months. After the strong market reaction to the Fed's communications in May, the central bank made some efforts to improve the quality of its forward guidance. The Fed reacted to the upward move in Treasury rates by working harder to convey the message that standard interest rate policy will remain accommodative while its unconventional QE program will be unwound before the end of this year, depending on economic conditions. Bernanke discovered his inner dove when he stated that the unemployment rate probably understates the weakness of the labor market, particularly the low participation rate. Although we expect the Fed will not give away the progress it has made in preparing the market for tapering, we believe it will use the underlying weakness in the labor market and inflation running below its target to scale down the tapering expectations if necessary. The PCE price index remains low, although core CPI inflation rose to 1.8% in June.

US: manufacturing and non-manufacturing ISM indices



Source: Thomson Reuters Datastream

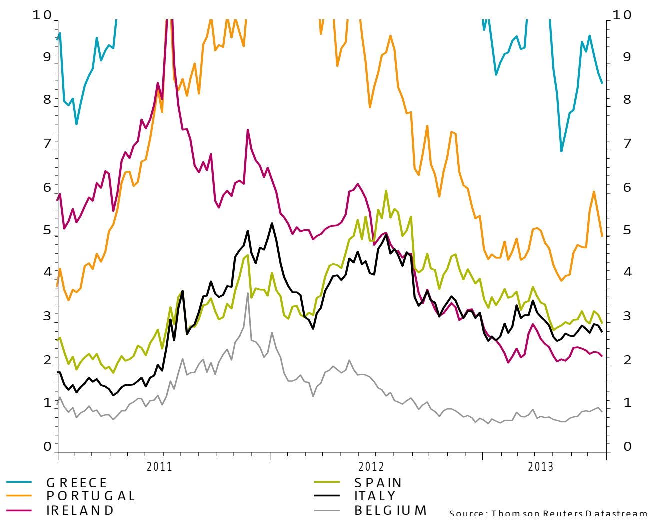
As Treasury rates have stabilized in recent weeks, we think yields will remain range-bound between 2.5% and 2.75%. This sideways movement in capital markets will likely not hurt the ongoing recovery. Trends in US new home sales confirm a strengthening of domestic housing demand. Pending home sales declined – by 0.4% in June - but this was above expectations, indicating that the fallout from higher mortgage rates seems limited so far. We do not expect higher mortgage rates to suffocate the recovery in the housing market. We also do not expect the US economy to accelerate in the third quarter, but to continue to grow at a modest pace. Tapering will probably start in the fourth quarter of 2013. An acceleration of the recovery is less likely as we think uncertainty about the US fiscal situation could flare up in the coming months. John Boehner, the Republican Speaker of the House of Representatives, made hawkish statements about the need for further spending cuts. Corporates and financial markets could become more nervous about a renewed standoff between Republicans and Democrats over the budget deficit and the lifting of the debt ceiling later this year when the temporary emergency cash measures taken by the Treasury in March expire.

Political instability in the Middle East has not abated, with increasing tensions in Egypt and Iraq. The possibility of oil supply disruption is more pressing in Iraq as the Suez Canal for shipping past Egypt remains safeguarded. The new moderate president of Iran, Hassan Rouhani, seems set to continue on his compromising path towards the West with the nomination of Javad Zarif, a respected figure in Washington, as foreign minister.

Europe

The UK economy did not disappoint again with Q2 GDP growth at an annualized rate of 1.4% and a manufacturing PMI reading of 54.6 for July. With the BoE committee voting 9-0 against further easing of monetary policy, more QE is now highly unlikely given the strengthening economy. However, one of the outstanding questions remains how new BoE Governor Mark Carney will follow up on his analysis that the UK economy needs to reach 'escape velocity' and how he wants this to happen. We remain doubtful whether we will see more forward guidance on the future of QE or interest rates in the short term.

Ten-year yield spreads versus Germany (%)



Recently heightened tensions in the euro zone have abated somewhat, as a potential break-up of the coalition government in Portugal was avoided, with a renewed commitment to the Troika's conditions. Greece has been given EUR 5.7 billion after the Troika concluded that "commendable progress" had been made. Although the Greek privatizations are not on schedule, the assessment was relatively mild for the Greeks as German Chancellor Angela Merkel won't risk another stand-off in the periphery before the German elections on 22 September. For now, Germany is resisting a second haircut for Greece, although such an outcome is inevitable. In Spain, Prime Minister Mariano Rajoy is struggling to hold onto his position after corruption charges. We think Rajoy is not a real political risk; if he falls, he will be replaced. Early elections will be avoided by the ruling Partido Populare at all costs. However, political danger lurks in Italy where it is becoming more obvious that the legacy of former Prime Minister Mario Monti has hurt domestic growth and a court conviction of his predecessor, Silvio Berlusconi, could destabilize the fragile coalition now led by Enrico Letta. New elections will be very uncertain for all parties involved, which does provide an incentive against breaking up the coalition.

Regarding the euro zone economy, more bright spots are appearing on the horizon. The euro zone composite PMI strengthened further from 48.7 to 50.4 in July. Although not a dead-cat bounce, we think this development confirms the stabilization of the euro zone economy rather than pointing towards a nascent recovery. Euro zone composite consumer confidence indicators suggest confidence is rising, but retail sales, especially in Italy, have dropped, and unemployment rates still indicate moderate wage growth going forward. The household savings rate rose to 13.1% in Q1 2013 compared to 12.4% in Q4 2012. Domestic demand in the euro zone will remain weak.

Against a background of ongoing stabilization in the euro area, we do not think the ECB will announce new unconventional measures like OMT (Outright Monetary Transactions) or a new LTRO (Long-Term Refinancing Operation). Announcing the potential use of OMTs has proved to be a very powerful form of verbal intervention. We expect the ECB to continue to use this line of communication, with forward guidance reiterating that interest rates need to remain low for an extended period of time. Better macro data and slowing disinflation, helped by rising energy prices, will help ECB President Mario Draghi to convince investors that the ECB is doing enough at the moment.

On the institutional front, developments are progressing very slowly. The German constitutional court is still considering the constitutionality of the ESM (European Stability Mechanism). If the court concludes that the ESM is not compatible with the German constitution, it would lead to renewed tensions in the euro zone, as it renders the ESM useless as a safety net. Although this is a low-probability event in our view, the impact of such a verdict would be even larger than Merkel losing the elections, as most of the German opposition also wants to move forward with Europe and the euro. The German government is considering filing a complaint at a European court against the European Commission's new banking plan, which foresees a larger role for creditor bail-ins before any taxpayer support can be given. Germany wants a sound legal basis for the banking resolution scheme, which, in its view, requires a Treaty change. We think the Merkel coalition will soften its tone after the September elections and eventually move forward, but if legal action over the banking plan drags on, it will delay the ECB from taking up its role as central bank supervisor until the end of next year. This also implies a postponement of moves to clean up bad bank balance sheets.

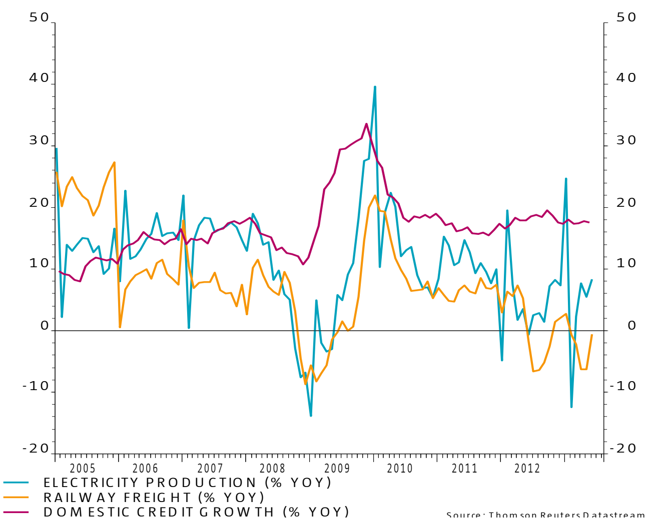
Pacific

Australia has seen a steep decline in its exports as its mining industry suffers from lower external demand and a strong Australian dollar. The RBA remains on the dovish side and is holding the door wide open for another interest rate cut if inflation developments provide leeway for supporting domestic demand and a further weakening of the Australian dollar.

In Japan, Abe has firmed his position with the LDP winning the Senate elections on 22 July, thereby eliminating the previous standoff between the Upper and Lower house. Although 'Abenomics' has now been given a broader mandate, it remains to be seen if Abe will use his victory for his nationalistic agenda or whether he will still make economic reforms his top priority. A litmus test for this will be whether he visits the controversial Yasukuni shrine, a highly nationalistic monument which commemorates those who died in the service of the former Japanese empire and causes offense to victims of imperial wars, particularly in China and South Korea, on 15 August. Japanese core CPI inflation rose to 0.4% in June. Although this could be seen as a promising sign for a possible exit from deflation, the increase was largely due to higher energy prices, and other CPI components do not indicate a broad-based reflationary trend. The yen is struggling to continue its downtrend vis-à-vis the US dollar.

BRICs

Chinese economic indicators preferred by Li Keqiang



Worries mounted last month about a slowing Chinese economy. The HSBC flash PMI came in at an 11-month low of 47.7 in July, indicating that the contraction is deepening. After the warning signal fired towards excessively leveraged Chinese banks through a higher SHIBOR (Shanghai Interbank Offering Rate), Chinese policy makers have now moderated their tone. The Politburo has announced new measures to mitigate the slowdown and aims to stabilize growth at 7.5%. Measures consist of investment in railroads, lower administrative costs for exporters and lower tax breaks for small enterprises. Premier Li Keqiang said 7% is seen as the "bottom line". An audit on local government debt needs to clarify the real debt burden, indicating that the Chinese authorities are gearing up to address the underlying growth challenges. For now, economic uncertainty remains high.

Brazil's central bank has raised its interest rate again to contain inflation by hiking the Selic (overnight bank rate) by 50 basis points to 8.5%. As inflation of 6.7% remains stubbornly above target, we expect the central bank will retain its hiking bias, although growth is faltering with the Purchasing Manager Index now standing at 50.4. As a large commodity exporter, Brazil is negatively affected by the slowdown in China. Exports declined –by 5.7% in Q1 2013 compared to a 2.1% fall in Q4 2012.

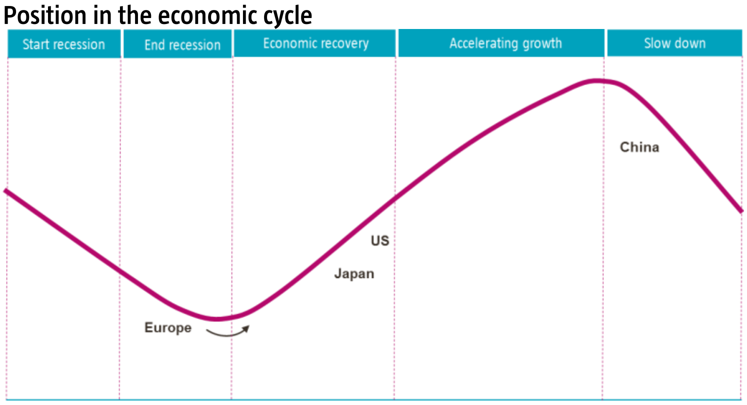
The Russian economy is lacking growth drivers. Industrial production saw a marginal expansion in June, rising by 0.1%. Inflation slowed to 6.9%, but the central bank held its rate unchanged in July. Eventually it will cut rates under its new female president Elvira Nabiullina, but probably only in the next quarter if inflationary pressures abate further.

Indian policy makers are sending mixed signals while trying to stabilize the current account as the rupee depreciates. The rupee will remain under pressure as the central bank unexpectedly sounded dovish and kept the benchmark rate at 7.25 % on 30 July. The RBI also signaled that the liquidity squeeze created last month to ramp up the rupee is temporary.

Position in the economic cycle, macroeconomic scenarios, and Robeco's view versus consensus

Global economic growth will be lower than trend due to structural problems. Currently we see a weakening in global growth momentum. Our baseline scenario therefore remains one of below-trend growth, and we have raised the likelihood of this slightly, to 70%. The likelihood of a global recession has diminished to 10%. We maintain our forecast of 20% for the likelihood of a traditional recovery because of positive developments in the US economy, a stabilizing Europe and a modestly improving Japan.

Position in the economic cycle



Macroeconomic scenarios

Structural problems — Cyclical recovery

Recession (10%) — Sub-trend growth (70%) — Traditional recovery (20%)

Source: Robeco

Consensus estimates of economic growth and Robeco's expectations

GDP growth by region (%)	*2012*	*2013*	*2014*	*Δ-1m 2013*	*Robeco**
US	2.2	1.8	2.7	-0.1	=
Euro zone	-0.5	-0.6	0.8	0.0	-
UK	0.2	1.0	1.7	0.1	=
Japan	1.9	1.9	1.5	0.0	=
China	7.8	7.5	7.6	-0.2	-
India	5.0	5.9	6.6	-0.1	=
Brazil	0.9	2.5	3.2	-0.5	-
Russia	3.4	2.6	3.2	-0.3	=
World	2.0	1.9	2.7	-0.1	=

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

Source: Consensus Economics, Robeco

Consensus estimates of inflation and Robeco's expectations

CPI by region (%)	*2012*	*2013*	*2014*	*Δ-1m 2013*	*Robeco**
US	2.1	1.5	1.9	0.0	=
Euro zone	2.5	1.5	1.5	0.0	-
UK	3.2	3.2	3.0	0.0	=
Japan	0.0	0.0	2.1	0.0	=
China	2.6	2.6	3.2	-0.3	-
India	10.3	8.1	7.3	-0.1	-
Brazil	5.8	5.8	5.6	0.1	=
Russia	6.6	6.0	5.6	0.1	-
World	2.6	2.0	2.4	0.0	-

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

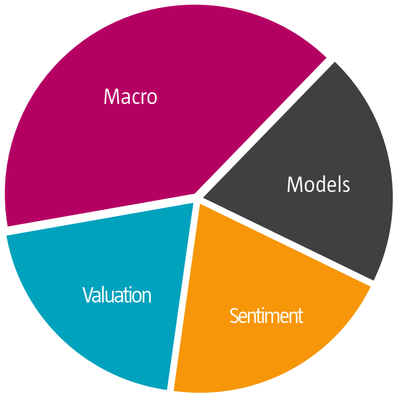
Source: Consensus Economics, Robeco

Financial markets outlook

Our expectations are based on qualitative and quantitative analyses. Our starting point is to look at the long-term macroeconomic environment. We then determine our expectations for the economy for the next three to six months to find out which developments could take the market by surprise, as this is a common factor for all asset classes. This macroeconomic analysis determines our initial preference in terms of assets.

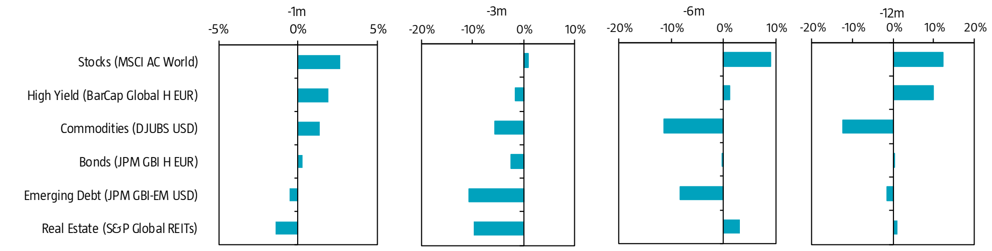
Next, we challenge our macro analysis with input from financial markets. Here, we take valuations into account as, at extreme levels, this might cause the performance of an asset class to change direction. Sentiment also plays a role, as markets tend to extrapolate shorter-term trends as investors put too much weight on recent developments. Finally, we use quantitative models to steer our expectations.

Input factors for our investment policy



Asset allocation

Performance of asset classes (gross total return)

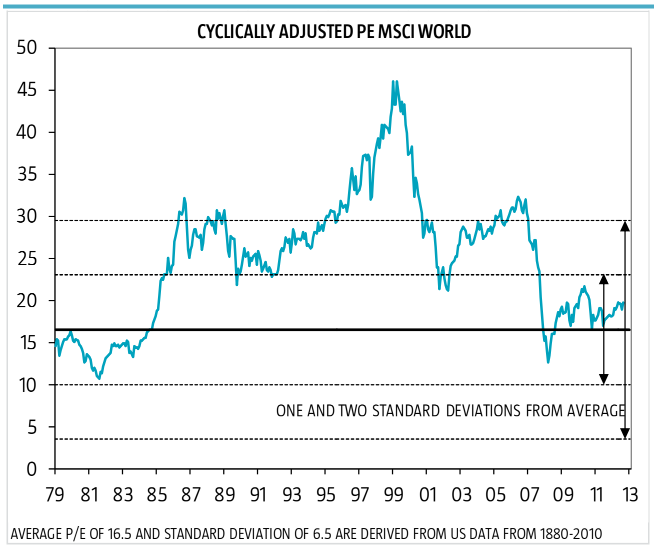


Source: Thomson Reuters Datastream, Bloomberg. Robeco

Equities

We maintain our positive view on equities. Interest rates will be artificially depressed for the foreseeable future. We do not expect a significant improvement in the global economy in the months ahead. Moderate economic growth results in an attractive macroeconomic environment. Corporates are reluctant to invest, and so depreciation costs remain low. Neither interest costs nor labor costs threaten the attractive profitability of companies. As long as interest rates are low, investors probably care less about the fact that earnings are hardly growing. Earnings revisions will continue to be negative as there is still some traditional optimism in earnings estimates. This will not affect stock prices. Stocks are slightly overvalued - we think by around 15%. However, this does not play a role in the short term. In short, we remain positive on equities.

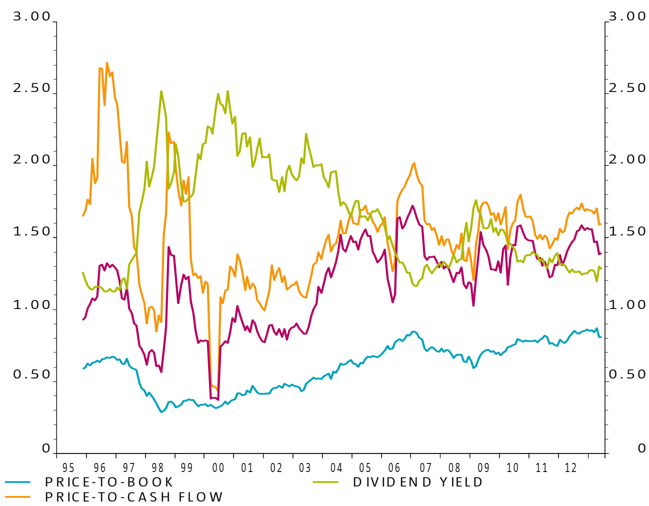
Valuation MSCI World



Real estate

We are neutral on real estate, which outperformed equities when interest rates and interest rate spreads were falling. Spreads can still fall further, but the support afforded by falling rates is over. Economic data underline the ongoing recovery of the US economy and producer confidence data suggest that the euro zone economy has bottomed out. For now it seems that long rates will at best move sideways from here. At least, it is likely that the Fed will begin to scale back quantitative easing in September or November. In short, the interest rate environment is now at best neutral for real estate. Valuations do not provide support. With dividend yields relative to equities close to their lows, we think the outlook for equities is more attractive than real estate.

Valuation ratios real estate versus equities (global)

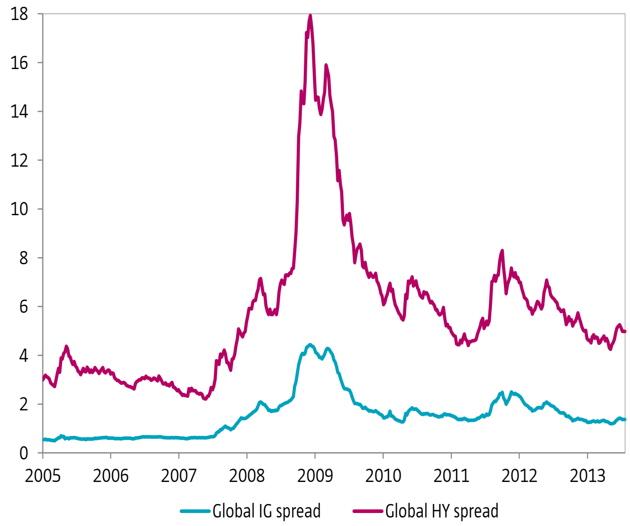


Source: Thomson Reuters Datastream

Investment grade credits and high yield

We hold on to our positive view on high yield. In June, the asset class fell 3%, but in July there was a 2% rebound. There is one negative factor for high yield: the 'covenant lite' issuance has reached an all-time high. However, as we will move from below-trend growth to trend or above trend in the years ahead, we expect low default rates. This factor is likely to come into play at a later stage. In the meantime, spreads remain attractive and, contrary to investment grade credits, still offer the potential of a reasonable absolute total return. We have a neutral view on credits. The credit spread-to-leverage ratio has worsened as corporates have taken on more leverage. In terms of risk factors, the less bondholder-friendly environment and higher correlation with country risk imply a more volatile environment for credit.

Spreads for global credits and high yield

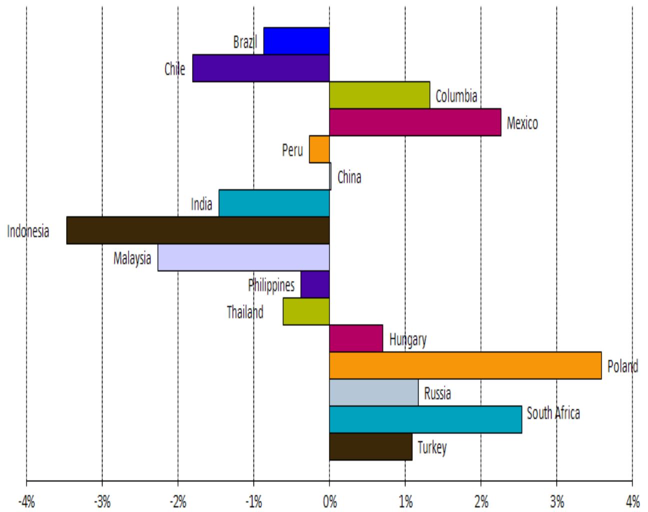


Source: Bloomberg, Robeco

Emerging market debt

We maintain our neutral position as we are convinced that HY corporate debt still offers better risk/return perspectives as the US economy revives. EMD currencies returns showed a mixed picture as several countries hiked rates to counteract capital outflows, which helped their currencies appreciate. An overall weaker dollar also helped ease currency pressures last month. Credit spreads did not widen significantly compared to the previous month as sentiment improved and some investors returned. Risk aversion eased somewhat as political risk stabilized at heightened levels. A mining deal was struck in South Africa and the improved health of Nelson Mandela eased tensions. Elsewhere, tensions remain. Civil unrest in Brazil, mainly stirred by excessive consumer prices, is still ongoing. Turkey has not made itself popular with its authoritarian crackdown of political protests last month, but, despite the unrest, its current account deficit was helped by high tourism revenues. The most recent industrial production figures do not suggest there is ample cushion to sustain further rate hikes in EM. Brazil and other commodity exporters could experience further trouble if, as we expect, rate hikes will continue against a background of weakening commodity markets. Mexico, on the contrary, is well positioned to profit from better exports to the US. We therefore expect a sideways pattern for EM countries, with more divergence between EM countries as excess liquidity will abate in the wake of Fed tapering and as different counter-cyclical policy reactions undertaken by EM policy makers generates different macro effects in the near term.

One month dollar returns for emerging market currencies

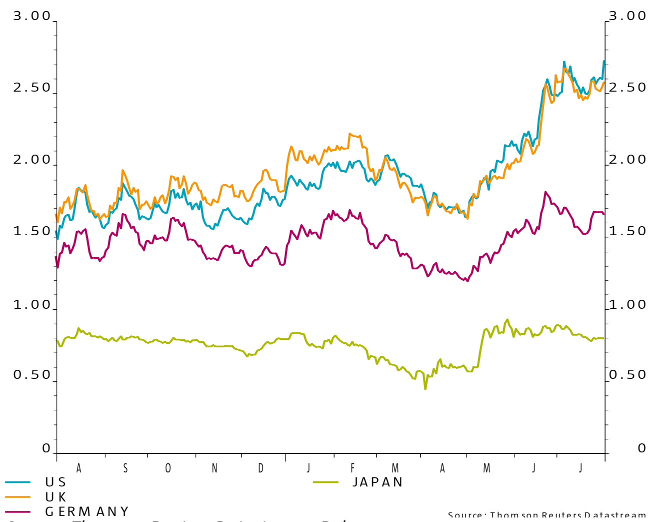


Source: Bloomberg, Robeco

Government bonds

We remain negative on government bonds. After a strong rise in yields in May and June, markets calmed after central banks indicated that short-term interest rates will remain low for an extended period of time. This will be a drag on the yield curve. The most recent economic data surprised on the upside, but we are still away from a period of trend or above-trend growth. Inflation risks are muted in such a macroeconomic environment. Currently, headline and core inflation in both the US and euro zone are clearly below 2%. For these reasons, a further rise in global yields is not likely in our view. Therefore, government bonds remain the least attractive asset category. We expect riskier assets to outperform government bonds.

Ten year interest rates

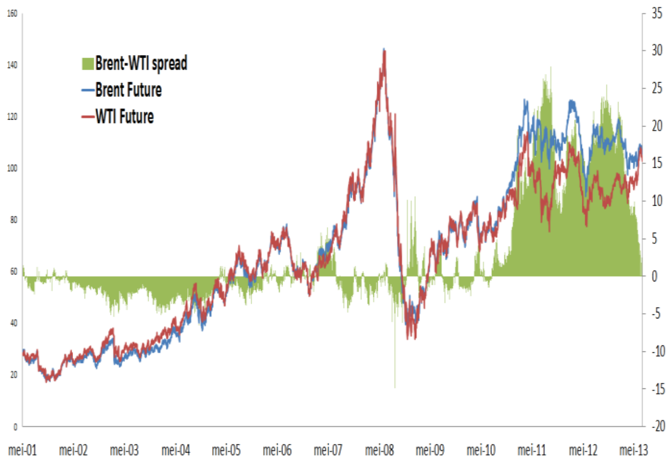


Source: Thomson Reuters Datastream, Robeco

Commodities

We remain underweight commodities. The increased concern about a slowdown in China is putting downward pressure on basic materials and energy prices. Also, the increase in bond yields raises the opportunity costs of holding commodity inventories from an investment perspective, especially gold. As dollar strength is expected to continue with the ongoing recovery, demand for dollar-denominated commodities will suffer against a background of sub-par global growth. The picture is mixed however within the commodity universe. WTI oil prices rallied significantly as excess supplies at Cushing were increasingly transported to the Gulf Coast. However, we expect WTI to fall, again widening the Brent-WTI spread as margins for refiners at the Gulf coast have fallen to just above break-even levels and a more range-bound Treasury rate will provide less incentive to disinvest in inventories. On the Brent side, geopolitical risk will remain priced in, although crucial supply through the Suez Canal and pipelines in Egypt is still safeguarded by the Egyptian army.

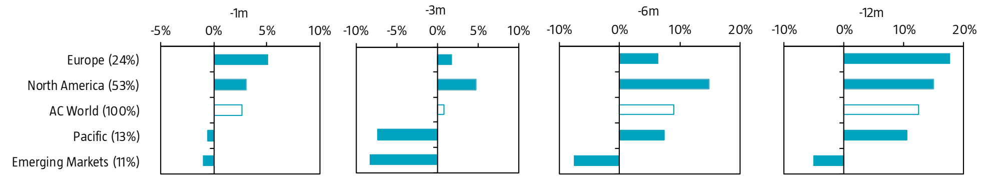
Brent-WTI spread



Source: Bloomberg

Regional allocation

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



Source: Thomson Reuters Datastream, Robeco

We still favor North America. Its economic performance is good compared to other regions; earnings revisions underline this, and the region performs better than the global market. These three positive factors have brought a higher valuation, but, this should not hinder short-term performance. We are slightly positive view on the Pacific region. The weakening yen should help to improve the economic performance of Japan and earnings revisions are above average. For Europe we are still negative. Recent producer confidence data surprise on the upside, but relative performance and the earnings outlook were less supportive. We remain negative on emerging markets, where we do not anticipate an improvement in economic data. Earnings revisions are also bad, though we believe the downward potential relative to other regions is limited. Otherwise, valuations should start to support the market.

Earnings and valuation data of regions (MSCI AC World)

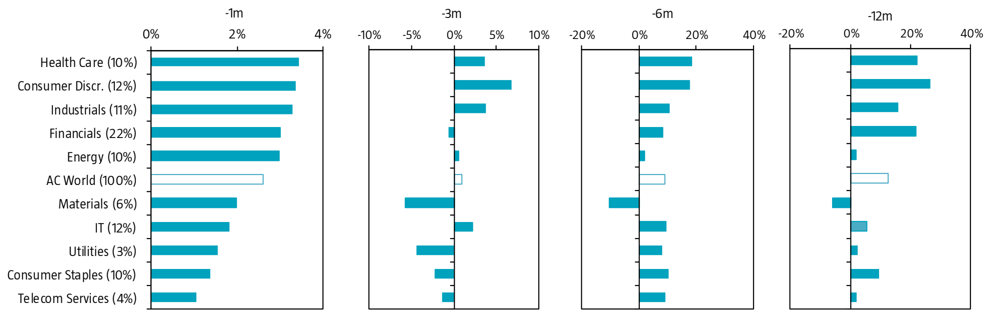
	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	*FY2*	*12m*	*3m*	*1m*	*Current*	*10y avg.*
North America	6.6	10.4	9.4	1.7	7.6	14.5	14.2
Europe	1.0	12.0	7.8	-33.9	-37.6	12.3	12.1
Pacific	33.6	10.2	26.0	9.1	-3.8	14.6	15.4
Emerging Markets	10.6	11.4	11.3	-24.4	-28.8	10.1	10.8
AC World	8.3	10.9	11.0	-12.3	-7.5	13.3	13.3

The earnings revisions index is calculated as the difference between the number of up- and downward revisions relative to the number of total revisions.

Source: Thomson Reuters Datastream, Robeco

Sector allocation

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



Source: Thomson Reuters Datastream, Robeco

We do not have a strong view on cyclical versus defensive sectors at this moment. From a macroeconomic point of view, recent positive surprises should underpin cyclical sectors. However, global economic growth will likely remain modest. Moreover, relative momentum and earnings revisions do not clearly favor cyclicals or defensives.

Earnings and valuation data of sectors (MSCI AC World)

	Earnings growth (%)			*Earn. rev. index*		*P/E on 12m fwd earn.*	
	FY1	*FY2*	*12m*	*3m*	*1m*	*Current*	*10y avg.*
Energy	-0.2	8.4	4.9	-9.9	5.9	10.7	11.1
Materials	-0.2	17.4	14.1	-47.9	-43.1	12.8	12.3
Industrials	9.8	14.4	13.6	-17.7	-13.8	14.3	14.3
Consumer Discr.	17.5	12.2	17.1	6.1	8.2	15.0	15.4
Consumer Staples	7.2	10.4	9.4	-50.1	-59.4	17.1	15.8
Health Care	0.5	9.3	5.7	-4.5	0.0	15.7	14.5
Financials	13.2	10.0	11.5	1.2	12.1	11.6	11.3
IT	9.7	12.1	12.9	-0.1	1.0	13.1	16.5
Telecom Services	1.7	7.2	4.8	-12.7	-14.3	13.2	14.9
Utilities	24.5	7.5	19.7	-12.9	-40.0	14.0	13.7
AC World	8.3	10.9	11.0	-12.3	-7.5	13.3	13.3

The earnings revisions index is calculated as the difference between the number of up- and downward revisions relative to the number of total revisions.

Source: Thomson Reuters Datastream, Robeco

Closing date text: 03 August 2013.
We refer to calendar months in all our data tables.

Important information