



New realities

Quarterly Outlook Q3 2013

Investment
Strategy

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New realities

A paradox is upon us. While central banks mitigated market uncertainty through quantitative easing, doubts are now being detected about the exit from this accommodative stance. Yet, such prospective policy shifts also provide the potential for broader economic normalisation in the medium term.

As the global economy gains momentum, the challenge in the coming quarter is to make portfolios less dependent on monetary stimulus, while adding exposure to genuine sources of growth. ABN AMRO believes investors should home in on assets based on the global recovery, targeting domestic US equities, international European equities and companies and industries engaged in new retail trends. Portfolio allocation should focus on corporate profitability, instead of monetary easing, as government bonds and expensive investment-grade bonds are expected to suffer during the gradual withdrawal of central-bank support.

On the following pages, the ABN AMRO Private Banking Research & Strategy team examines these and other views – including recommendations related to property, hedge-funds and foreign-exchange opportunities – to help you profit from the new economic realities and invest successfully. Your Relationship Manager or nearest Investment Advisory Centre (see back cover) is also ready to assist you in selecting the asset allocation reflecting the risk/return strategy that best meets your investment objectives.

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New realities

As the global economy gains momentum, investors must seek companies that will succeed based on sustainable sources of growth, not central bank largesse

After five years of extraordinary monetary policy actions by central banks around the world, new realities beckon. The global economy, led by the US, is beginning to reaccelerate. The good news is that gradual improvement will likely occur without the threat of rampant inflation. A key challenge for financial markets stems from a new form of uncertainty: market nervousness and anticipation of when and how central banks will begin to reverse their now long-standing accommodative monetary policies.

Recent adjustments result in our asset allocation being slightly less overweight equities, less exposed to bonds and neutral on property. We are encouraging investments that will benefit from the global economic recovery. The changing dynamics of the market represent a chance to concentrate exposure in growth stocks that will benefit from the rotation out of defensive stocks. Meanwhile, assets largely dependent on the free flow of cash from central banks, such as core government bonds and expensive investment-grade bonds, are ripe for profit-taking.

Key trends: an accelerating global economy and a shift from austerity to growth

- **Global economic improvement.** The global economy will reaccelerate in the second half of the year. The US recovery will be self-sustained, confidence in the eurozone will progressively improve and China will continue to encourage consumer demand.
- **Growth instead of austerity.** The eurozone has backed off from fiscal severity, the US budget deficit is shrinking rapidly and Japan is engaged in a stimulus experiment.
- **Corporate earnings will improve:** low input prices, including for labour and energy, will support earnings as demand rebounds.

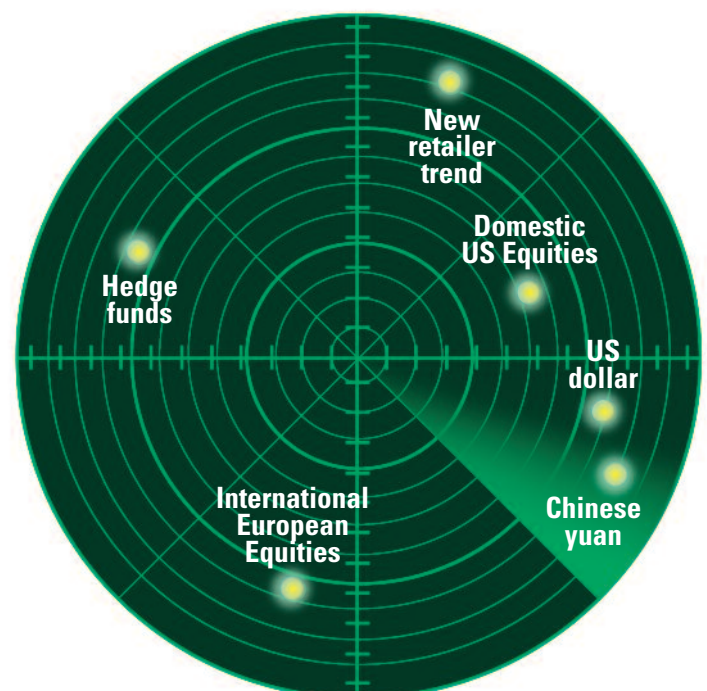
Key challenges: the collateral risks of the transition to more normal markets

- **The uncertainty of the future course of US monetary policy** is disruptive for risky assets in the short term. Central banks want to avoid their huge monetary creation fuelling financial asset bubbles. Corrections in gold and Japanese equities illustrate this vulnerability.
- **If not well managed, the Fed's normalisation could slow the global recovery,** in particular with a negative impact on the US residential sector through rising mortgage rates.
- **Valuations are stretched.** In the rush for yield in fixed income investments, valuations have become rich. While the low yields on investment-grade bonds limit returns, the lure of complex fixed income instruments is not the solution.

Key opportunities: the quest for earnings

- **Higher volatility provides buying opportunities.** Market dips can provide entry points to diversify into smaller US stocks with domestic exposure and European international growth companies with exposure to Europe and Asia (primarily China, Taiwan, and Malaysia).
- **Focus on new strategies in retailing.** New buying trends and consumer habits, such as online purchases using smartphones and tablets, are generating growth and change. The repercussions are diverse and worldwide. (See our latest equity theme: The New Retailer.)
- **Growth currencies.** We expect a stronger US dollar and Chinese yuan, based on a revival of US economic leadership and the growing internationalisation of the yuan.

Opportunities on the radar



Economics – Increasingly confident

**Research & Strategy
and Group Economics**

Han de Jong – Chief Economist

We are increasingly confident that the global economy will gain momentum in the second half of the year and beat expectations in 2014. For the first time in years, we have raised our GDP growth forecasts for the US and the eurozone.

The global economy has encountered another soft patch. There are some good reasons for it. For example, the tax hikes in the US at the start of the year and the subsequent spending cuts, the inventory cycle on the part of companies globally, austerity in Europe, the – to some extent – deliberate slowing of the Chinese economy have all played their part.

Virtuous circle in US

There is every reason to believe that this year's soft patch will be short lived and followed by a clear acceleration, as headwinds dissipate and tailwinds develop. The US plays the main role here. The improvement in US private sector balance sheets is laying the foundation for stronger spending on the part of households and corporates. Banks are more willing to lend than they have been for years. Even the budget deficit of the US government is developing more favourably than expected. While fiscal policy has been a significant drag this year, austerity will diminish. In addition, inflation is easing, boosting real spending power. Meanwhile, monetary policy is set to remain very accommodative. We expect all these forces to become stronger and to reinforce each other.

Breathing space in Europe

The outlook for Europe is clearly less favourable, but also improving. The eurozone economy will benefit from stronger growth in the US. Significantly reduced stress in the system is also important. So is lower inflation and the fact that austerity appears to be past its peak and countries have been given some extra time to achieve challenging deficit targets. We have all become used to gloomy comments about the eurozone and that is understandable. But some cyclical indicators have started to turn up recently, underscoring our view that the economy will stabilise and resume some growth before too long. Business confidence is weak but strengthening, consumer confidence has risen in six consecutive months and the competitiveness of the peripheral economies has improved materially. Of course, the large challenges remain and the euro crisis could easily intensify, but we believe that policymakers have the tools and the willingness to act should that become necessary.

Japan's second life

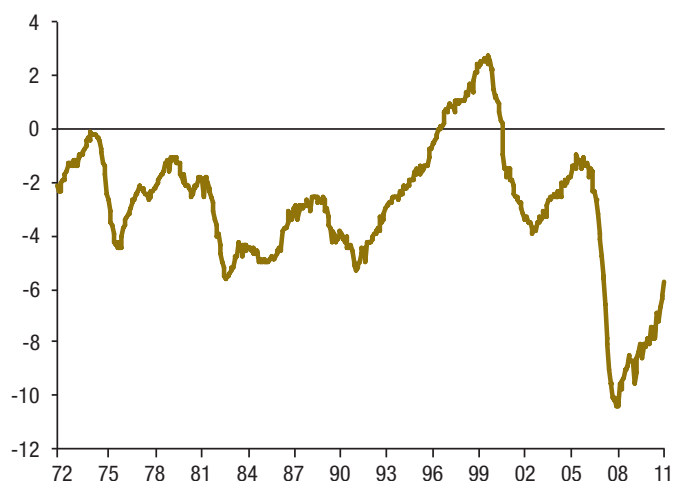
The spectacular experiment of Japan's policymakers appears to be working for now. No one can say with certainty what the ultimate outcome will be, but so far so good. And for the next 18 months at least, we think that economic growth will be relatively solid.

Deceleration is no halt

Emerging economies have disappointed somewhat, and the outlook for them is generally for decent, but lower growth than in the not too distant past. Currency appreciation, higher wage increases and inflation, targeted measures in some countries to cool property markets and the declining trend of commodity prices are all factors dampening growth prospects.

The interesting feature is that the recovery is gathering pace with far fewer imbalances than before the crisis, laying the foundation for a more sustainable growth path.

US budget deficit as a % of GDP 1972 - 2011



Source: Bloomberg

China's new wave

The changing nature of commodity demand

China is a leading player in the world commodity market. It dominates not only because of the size of its economy and still rapid pace of growth, but also because of its intensive use of certain commodities. Its current transformation towards consumption-led growth is likely to prompt a transition that will be crucial for commodity markets, as Chinese demand for commodities changes.

From metals to food and energy

China's strategic policy decisions have major implications for commodity markets. In the wake of the 2009 global financial crisis, Chinese policymakers undertook a huge stimulus programme, triggering an unprecedented construction boom. This strategy had a significant impact on the demand for metals.

A major determinant of industrial commodities/metals demand is the property market. The Chinese government's current policy is intended to curb excesses there, without disrupting the economy. This will be on the back of a rebalancing strategy that favours consumption instead of investment and that will result in a more moderate rate of economic growth.

We are already witnessing a change in demand towards food and energy and away from metals. The demand for agricultural commodities will probably undergo constant shifts, due to changing consumption patterns and rising incomes. The traditional grain-intensive diet is now making way for proteins, dairy products and processed food.

In terms of energy demand, China's per capita energy consumption is only one-third of the average per capita rate in OECD countries. But as the growing middle class purchases more cars and electrical appliances, energy consumption is surging, a trend that is likely to continue.

Self-sufficiency in commodities as a policy

China has promoted its goal of self-sufficiency in key commodities thanks to the important role the state plays in their production. State-owned hard-commodity producers have at times operated at a loss, just to achieve self-sufficiency.

But total self-sufficiency is still elusive. China is self-sufficient in the production of refined aluminium, for example, but is dependent on external sources of raw materials, such as copper, nickel and zinc. The country is also the world's top steel-producing country, but it lacks high-quality steel-making

Group Economics
Maritza Cabezas Ludena – Senior Economist Emerging Markets

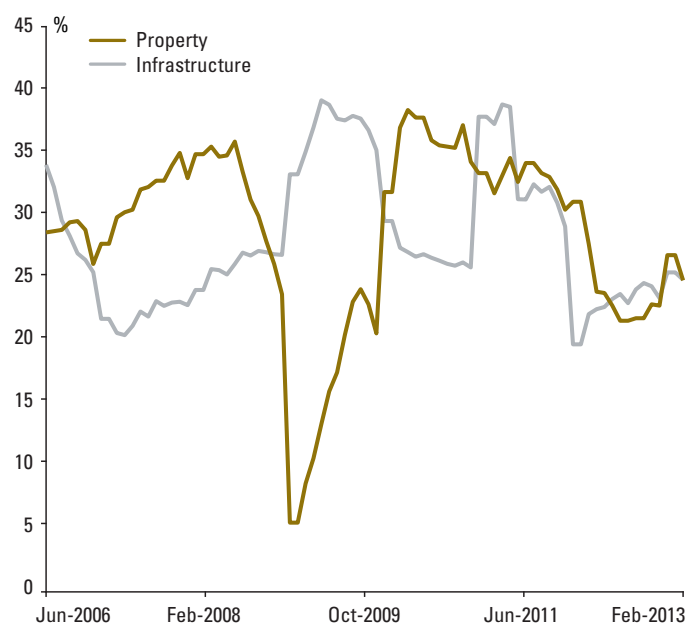
raw materials, such as iron ore and coking coal, rendering it highly dependent on imports. To address these gaps, China is making large investments in commodity-rich nations.

In agricultural commodities, the authorities insist that China's self-sufficiency in producing essential staples, including rice and maize, is sustainable until at least 2020.

China has been successful in pushing up agricultural productivity, despite the loss of arable land as a result of rising urbanisation. Since the late 1970s, China has never failed to source less than 95% of its grain demand from domestic suppliers, with one of the few exceptions being soybeans.

The pace of China's transformation will be crucial to the future of commodity markets.

China: investment growth losing steam year over year



Source: CEIC

No walk in the park

The Fed's challenge is to manage expectations

Group Economics

Nick Kounis – Head Macro Research

Concern has grown about the Fed's exit

Financial markets have once again started to fret that the Federal Reserve will reduce its monetary stimulus. Fed Chairman Ben Bernanke signalled in May that if the labour market recovery was sustained, the pace of asset purchases could be reduced 'in the next few meetings.' This means that although many commentators assumed that such a move would not come until 2014, a reduction in asset purchases could be announced before the end of the year.

The Bank of Japan (BoJ) also contributed to the uncertainty about central bank policies when it sounded confused in May about whether the aim of its asset purchases was to push down government bond yields. Worries about the future direction of monetary policy undermined risk appetite and led to a rise in government bond yields globally. The ghost of 1994, when abrupt Fed monetary tightening led to a bond market massacre, is the big fear.

Subdued inflation gives the Fed time

Navigating the exit from the biggest monetary policy experiment in history will be no walk in the park for Bernanke and his colleagues, but they do have some important advantages. The first is that they have had a long time to think about the strategy of how to return to more normal monetary policy and to develop a clear plan. In addition, underlying inflationary pressures are subdued (see graph), which will allow the central bank to take its time.

We think that the Fed will announce a tapering of its asset purchase programmes in December, although there is a chance of an earlier move in September. Purchases could come to a halt by the middle of next year, but we do not expect official interest rates to move up until early 2015. Over this period, the central bank will manage the degree of liquidity in the financial system using various tools, but its biggest challenge will be to manage expectations. To this aim, we expect the Fed to become increasingly transparent about its likely future actions. The favourable outlook for inflation and strong communication should ensure that the economy and markets are carefully and gradually weaned off monetary stimulus.

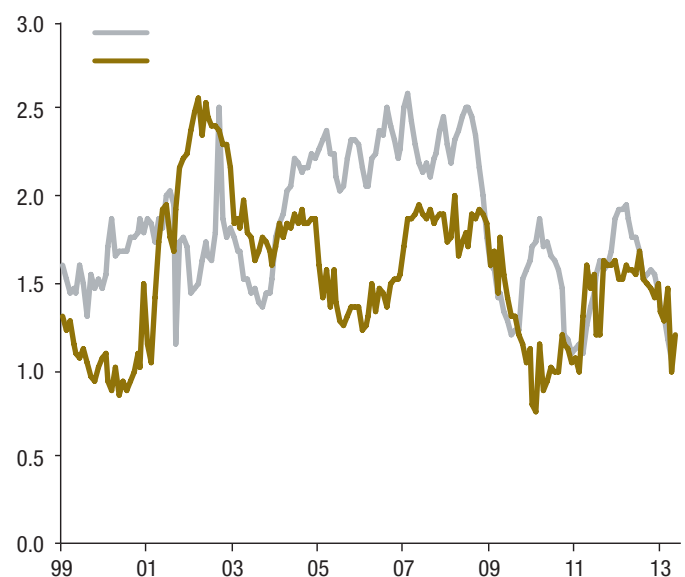
Managing the revolution

BoJ Governor Haruhiko Kuroda is also on the right road in terms of sharpening the institution's communication with regards to its revolutionary monetary policy. He has clarified that the rise in bond yields reflects an improved outlook for the economy and prices, which is actually the goal of the

central bank's policy. On the other hand, refinements have been made to the bond purchase programme to reduce market volatility. We think that the BoJ is committed to continuing its aggressive easing for as long as it takes to beat deflation.

In Europe, the ECB also looks set to keep an accommodative policy for the foreseeable future, given the likelihood of a weak recovery and modest inflation. Further cuts in its policy rates seem unlikely. Possible future tools include additional policies to improve bank access to liquidity to promote lending and stronger communication to assure markets that rates will remain low for a prolonged period.

Subdued inflationary pressures in % 1999 - 2013



Source: Thomson Reuters Datastream

Equities – Market outlook

Firmer ground ahead

Research & Strategy

Sybrein Brouwer – Global Head Equity Research
and Head Research Netherlands

Market corrections, such as the one seen in May/June, will not break the back of the equity bull market. But they should focus investor interest on company fundamentals. Many investors believe the end to the monetary-easing programmes, which was a factor in the recent correction, will be negative for equities. But we do not agree. We maintain our call for an Overweight for the asset class even after the profit-taking we implemented in early June.

First and foremost, policy change will be based on evidence of improvement in the US economy, which bodes well for better earnings prospects (see graph). The earnings outlook in the mid- to longer term is solid. Second, as the recovery takes hold, margins will simultaneously benefit from low input costs and a recovery in top-line growth. In a low-inflation environment, a modest increase in interest rates is not necessarily negative for earnings. Finally, despite some short-term volatility, equity valuations are reasonable and attractive in comparison with other asset classes.

Regional choices for growth

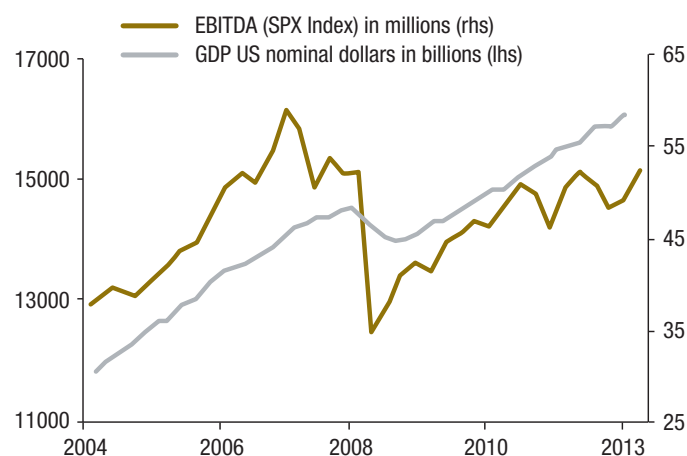
On a regional level, our Overweight in emerging markets is focused on Asia. These markets are attractively priced, given their sensitivity to the revival of growth in the US and Japan.

In the US (Neutral), we emphasise domestic players, as we expect demand growth to accelerate as the effects of the automatic government spending cuts fade.

Europe is Underweight given its lagging economy. The EU's policy shift from austerity to growth and its efforts to regain competitiveness is reducing the gap between Germany and peripheral countries. This suggests it is time to take profits in expensive German segments, such as consumer staples, and move to broader European equity exposure.

Japan (Neutral) appears to be benefiting more strongly and quickly than expected from the government and central bank's monetary and fiscal stimulus. Here, we focus on sectors and stocks with low valuations and restored profitability. This includes the auto industry, as it rolls out next-generation car models and benefits from contributions from key export markets.

US GDP and total S&P broad operating income (EBITDA)



Source: Bloomberg

Asset class	Fundamental view	Our recommendations
Equities Overweight	Economic recovery in US and Japan, supporting global growth and earnings.	The summer correction creates opportunities to take positions in large global industrials, select IT stocks and US domestic-oriented players, and broad indexes in Europe, such as the STOXX Europe 600.
	Renewed earnings recovery in Asia, particularly in China and other emerging markets.	Take emerging markets Asia exposure, either directly or indirectly.
	On-line shopping is changing traditional retail models.	Focus on trend setters, strong brands and distributors.

Equities – Sector outlook

Getting started with sector rotation

Research & Strategy

Sybre Brouwer – Global Head Equity Research
and Head Research Netherlands

Certain defensive, high-yielding parts of the market have performed very well and have started to become fully valued. For that reason, we have lowered our rating on Consumer Staples to Underweight, with an Underweight for the Food, Beverage & Tobacco segment and reduced exposure to Household & Personal Care. We have also reduced exposure to Consumer Durables within the Consumer Discretionary sector and Software & Services within IT.

We re-allocated some money towards the more cyclically oriented and attractively valued segment of the market, by

raising IT to an Overweight, with an emphasis on Technology and Hardware & Equipment. We believe that the IT sector will benefit from a gradual pick-up in global growth in the second half of 2013 and from pent-up demand. Within Consumer Discretionary, we have upgraded Automobiles & Components.

We continue to Overweight the Industrials sector, as it can benefit the most from increased productivity in the manufacturing industry. Both IT and Industrials also match our latest theme “The New Retailer”.

Overweight - Neutral - Underweight

Sector	Subsector	Comments
Energy	Oil Services	High investment spending by explorers / production is good news for leading service providers
	Integrated Oils	Vertical integration helps, US sector better positioned
	Exploration & Production	Expensive and capital intensive with falling prices, better asset reserves outlook for US companies
	Refining	Lower energy prices good for refining margins, but demand outlook poor in Europe
Materials	Chemicals	Demand recovery: Asia on inventory cycle, US on low gas prices
	Metals & Mining	Overcapacity and slower demand, also reflected in price-related commodities
	Construction Materials	Positive in US, neutral in EM, negative in Europe (UK, Germany are exceptions)
	Paper & Forest	Focus on further consolidation and integration/synergies
Industrials	Commercial Services & Supplies	No real improvement in hiring plans for second half of 2013 expected
	Capital Goods	Infrastructure and efficiency improvements are drivers; Europe and mining remain weak
	Transportation	More passengers but still deep cutbacks and restructuring, favour builders and price fighters
Cons. Discretionary	Consumer Durables ▼	Long-term prospects for luxury goods are positive, but valuations are getting stretched
	Consumer Services	European hotel sector to benefit from increasing travel from emerging markets
	Retailing	Threat from online retailing; Amazon and eBay to be the sector winners
	Automobiles & Components ▲	European car market is bottoming out, growth potential in US and emerging markets
Consumer Staples ▼	Media	No material improvement in advertising conditions; online business models still in development
	Household & Personal Care ▼	Limited upside margin potential; restructuring stories dominate, but expensive
	Food & Drug Retailing	Valuation seems attractive, but with cyclical and structural issues
	Food, Beverage & Tobacco	Volatile input costs; demanding valuation
Healthcare	Healthcare Equipment & Services	Dialysis services and instruments of interest and also laboratory equipment and testing
	Pharmaceuticals, Biotech & Life Sciences	Successful biotech product introductions; high free cash flows, share buy backs
Financials	Diversified Financials	US is doing well, while in Europe we keep to the quality names
	Insurance	Property & casualty have better premium income, re-insurance is also attractive, life insurance remains unattractive
	Commercial Banks	US is doing well, while in Europe we keep to the quality names
	Real Estate ▼	Quality assets in prime locations increasingly important
Information Tech ▲	Technology Hardware & Equipment ▲	IT investments will benefit from improving economic conditions, initially in the US
	Software & Services ▼	Cloud software trend completely changing the landscape and forcing acquisitions
	Semiconductors & Semicond. Equipment	More cautious following strong performance of the sector
Telecom	Telecommunication Services	Profit prospects remain grim due to lack of growth and continuing high investments
Utilities	Renewable Utilities	Subsidy uncertainty weighs on growth perspectives
	Regulated/Multi-Utilities	Big cuts in US electricity prices, also no pricing power in Europe

Equity theme – Megatrend update

Our latest theme, The New Retailer, focuses on consumer spending, one of the major drivers of growth in western countries and, increasingly, in emerging markets as well. The way that consumers spend is changing rapidly, as online shopping gains market share. Other important trends, such as automation and shale gas, continue to drive markets.

High dividend paying stocks are less at the forefront now, as the potential for somewhat higher interest rates begins to compete with it. Within Biological Solutions, pharmaceuticals remains strong but agriculture less so, as the biofuels trend faces challenges in the US.

Theme	Launch	Investment case	Key components	Current theme recommendation
Green infrastructure	3Q09	Long-term elements (environmental friendliness and energy savings) and short-term reasons (stimulus programmes) benefit “green” infrastructure	Ecolab, Syngenta, Arcadis, Veolia, Fluor	Buy
Big is beautiful	4Q09	Focus on large companies that can expand in emerging markets (EM) to become real global players	Samsung Electr., HSBC, Roche, Oracle, Coca-Cola, LVMH, Caterpillar, Walmart	Hold
Taking care	2Q10	The rising and changing needs of consumers in EM as they move up Maslow’s pyramid of needs	Samsung Electr., Adidas, Genting B., Mead Johnson, Heineken, Prudential	Hold
European gems	3Q10	European expertise and brand names are in demand with the rising middle classes worldwide, helped by a stronger USD	BASF, Daimler, Fresenius, L’Oréal, Sanofi, Siemens	Buy
Quality counts	4Q10	As production in EM moves up the value chain and global trade keeps on growing, the need for global quality standards, including environmental and safety regulations, is on the rise	Mead Johnson, Thermo Fisher, Symrise, Vopak, Fresenius, Keppel Corp.	Buy
The return of the consumer	1Q11	With the recovery (in the US and Asia) gaining pace, consumer spending is leading	Adidas, Apple, Daimler, FedEx, Randstad, Simon Property, Swatch, Wereldhave	Strong Buy
Mergers and acquisitions for a reason	2Q11	Companies are cash rich. Vertical integration and scarcity issues lead to more acquisitions	Mead Johnson, Mosaic, GEA Symrise, Starbucks, Actelion, Macarthur Coal, Qiagen	Hold
Pricing power	3Q11	In an age of austerity, pricing power is proving paramount for companies to maintain margins and secure long-term earnings growth	Apple, Philip Morris, Allergan, Lanxess, Coca-Cola, Nestle, Reckitt Benckiser, Starbucks	Buy
High-quality dividends	4Q11	In a low interest rate environment, investors focus on dividend-paying stocks as a stable source of yield	BASF, Philip Morris Intl., Royal Dutch, Roche, AT&T, Nestle, Bristol Myers, SingTel, Vodafone	Hold
The care industry	1Q12	Focus on health and wellness trends, relaxing in a high-stress environment	Allergan, WeightWatchers, Starbucks, L’Oréal, DaVita	Buy
Step on the gas	2Q12	Shale gas revolution in the US will have profound impact on different companies	Dow Chemical, BASF, LyondellBasell, Intl. Paper, Kinder Morgan	Strong buy
Biological solutions	4Q12	New solutions in biotechnology help find and develop renewable alternatives for fossil-based commodities and for pharmaceuticals	Ecolab, Actelion, Agrium, Amgen, BASF, Biogen, Celgene, Gilead, Mosaic, Roche, Sanofi, Syngenta	Buy
Masters of manufacturing	1Q13	Investment in production automation needed: productivity gaps have to be closed to stay competitive in the global marketplace	ABB, Siemens, BASF, GE, BMW, EMC, Hyundai, Michelin, Qualcomm, Samsung, Schneider	Buy
Closing the productivity gap in manufacturing	2Q13	Focus on systems and software to make automation processes work, including 3-D printing revolution	ABB, Apple, ASML, Cisco, Emerson Electric, Fanuc, Gildemeister, Kuka, Oracle, Qualcomm	Buy

Research & Strategy

Edith Thouin – Head Equity Theme Research

Equity theme – The new retailer

The continuing popularity of smartphones and tablets has changed shopping habits globally. This evolution has implications for many industries and companies – both positive and negative.

For consumers, shopping hours are no longer restricted and the variety of goods is not limited by what a shop can display and keep in stock. Easy price comparisons make the environment even more competitive, resulting in lower prices. For retailers, costs can be significantly reduced, including expenses related to holding large inventories and rent costs. It may no longer be necessary, for example, to rent retail space in so many different and sometimes less profitable locations. Moreover, fewer stores also means reduced outlays for sales personnel.

While lower costs are a definite positive for retailers, investments in information technology and creating a network of warehouses with highly automated logistics systems can be significant. Taking this into account, the lower margins that will be – and already are – a feature with online retailers can only lead to a sustainable and profitable business if the scale is right.

A prime example of success in online retailing is the leading US provider Amazon, a company that industry experts

already call “the new Walmart” because of the range of goods it sells. Another successful e-retailer that we recommend is EBay.

Widespread effects of online retailing

It is not only the retailers and consumer sectors that are affected. Thanks to online retailing, manufacturers now have a new and increasingly international range of platforms on which to advertise and sell their goods. Sophisticated and fast search engines, such as Google in the west and Baidu in China, are platforms for products and advertising for all kinds of e-retailers. While price pressures will increase, sales volumes can grow quickly, including internationally.

Road and air transportation companies, such as FedEx, will also benefit from high and growing demand for deliveries, both in the US, where FedEx is a market leader, and in international markets.

‘In line’ shopping centers and malls will remain a way for customers to see and evaluate the quality of products and provide an ‘entertainment experience’; investments in this area of property will keep their appeal. Simon Property Group (holding a large stake in Klepierre) and Unibail Rodamco are prime examples here.



Bonds – Market outlook

The bull market's 11th hour

Research & Strategy

Stephen Evans – Global Head Bonds

"A number of participants expressed a willingness to adjust the flow of purchases downward as early as the June meeting..." These words, from the minutes of a Federal Open Market Committee meeting released on 22 May, were all it took for markets to realise that the end of the Fed's quantitative easing (QE) policy was in sight.

Taken in conjunction with Fed Chairman Ben Bernanke's remarks that QE could be reduced if it was justified by positive US economic data, it is now expected that there will be some slowing of asset purchases before year-end.

Higher yields with end to asset purchasing programmes

The removal of liquidity will reduce support for the artificially high bond prices that we have seen in the past 18 months and result in higher yields. We have already seen a sharp rise in benchmark US Treasury yields and we expect this trend to continue into 2014.

Japanese Prime Minister Abe's policy of promoting a higher rate of inflation has also caused Japanese government bond yields to begin rising, breaking a decade-long trend towards near-zero interest rates. This is significant, as it could accelerate the move towards higher yields globally. We also expect Bund yields to rise over the rest of 2013 and into 2014, though at a much slower rate than US Treasuries.

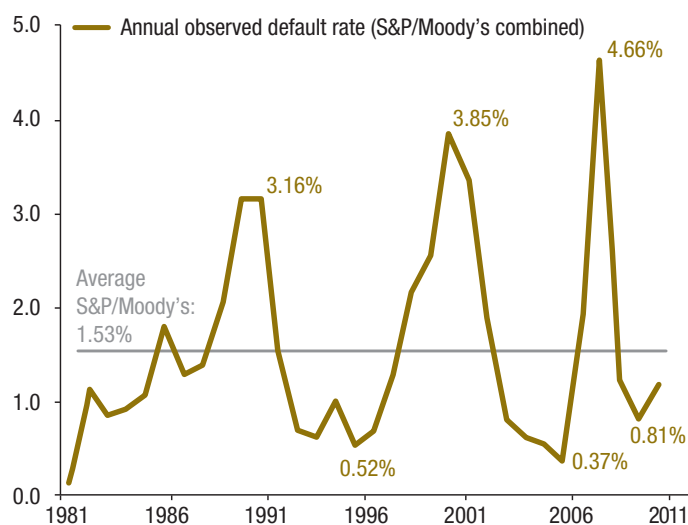
Given the improved economic outlook in developed economies – particularly the US – conditions are currently quite positive for taking on credit risk. Investors must understand, however, that the greatest current threat to bond

markets comes from technicals (i.e. rising benchmark yields) and not from a rise in default risk (see graph).

Beware of complicated structures in the search for yield

In conclusion, we express a note of warning to investors seeking to enhance yields by buying into complex bond structures from issuers that might be familiar to them. Good examples are recent issues of contingent convertible (CoCo) bonds issued by major banks in developed countries. We believe their higher yields come at the price of increased credit and market risk, due to their complexity.

Historical default rates in % 1981 - 2012



Source: S&P, Moody's

Asset class: Underweight	Fundamental view	Drivers	Our recommendations
Government: Underweight	Core government bonds with historically low yields give investors poor returns and little upside. Bonds yields could rise in anticipation of future policy changes, beginning with long US Treasuries.	Real yields on core government bonds are negative. Investors fearing losses from rising yields will exit positions.	Consider opportunities in eurozone periphery sovereigns as a way to enhance yield. Shorten duration on existing bond portfolios by exiting longer dated bonds.
Corporate: Overweight	Corporate balance sheets are currently strong, with low debt and good liquidity. The gradual return to economic growth in core markets will support credit fundamentals. Stronger growth in EM economies supports EM corporate risk.	Corporate default rates are falling to a cyclical low, narrowing spreads. Rating upgrades in EM will support outperformance of EM bonds.	Shorten duration by selling long-dated investment-grade bonds. Buy global high yield and select EM bonds.

Bonds – Portfolio allocation

Managing the risks

Research & Strategy

Roel Barnhoorn – Head Bond Theme Research
Carman Wong – Head Emerging Markets Bond Research

Two opposing forces are at work in bond markets. On the one hand, the global economy, and the US economy in particular, is improving. As a consequence, economic conditions remain positive for taking credit risk. But on the other hand, hawkish comments or actions by any central bank ready to reverse from very loose monetary policies, will have an immediate, negative impact on bond returns.

US Treasuries have started to lead the way towards a normalisation of yields. The recent rise in Japanese government bond yields has added additional uncertainty to global yields, a condition that is expected to persist through the third quarter and beyond.

Higher yields to drive investment-grade bonds

Investment-grade bond prices will be sensitive to the risk of higher yields in the core government bond markets. Yield spreads for investment-grade bonds are providing little compensation for this risk. We therefore recommend taking profits on high-grade corporate credits and reducing allocations to this asset class. Outstanding bonds with significant, above-par premiums and less than one-year maturities should also be considered for profit-taking.

Bonds with maturities longer than five years should be avoided. They are the most exposed to higher benchmark yields and are therefore the most vulnerable to hawkish comments from central bankers.

Core and emerging-markets bonds are expensive

Core government bonds, i.e. from the US, UK, Germany, Netherlands and Japan, are expensive. But this is also true of investment-grade emerging-markets sovereign bonds. Some are trading with only a small credit spread above core government bonds. Government bonds from peripheral eurozone countries are trading at relatively higher credit yield spreads, but are dependent on domestic progress with structural reforms and political stability.

Opportunities in corporate credits

With developed and emerging economies working on generating growth, corporate defaults are likely to remain low, relative to previous cycles. As a result, we continue to focus on bonds providing reasonable compensation for credit risk and where the probability of default is very low.

We remain positive on selected BBB-rated corporate credits, global high-yield bonds and emerging markets corporate bonds. A well-chosen universe of these credits can act as a buffer for interest-rate risks.

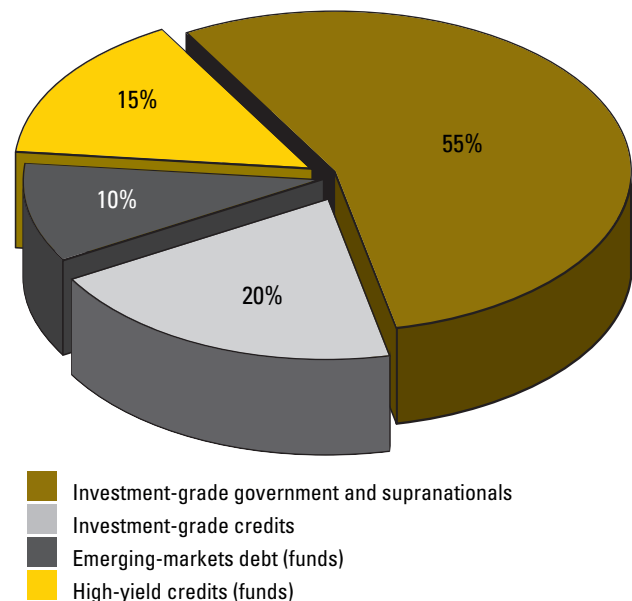
In Europe, we favour the infrastructure and utility sectors and some major financial institutions. Within emerging markets, we mainly focus on major Asian corporates, and, in particular, larger financial institutions and quasi-sovereign entities.

Risk within the bond universe

Bonds with medium (five to seven years) and long (more than ten years) duration could see some price fluctuations. A relatively short duration of four years should provide protection. Bonds with medium-term maturities are the preferred segment until new opportunities develop, with individual senior cash bonds providing better protection than subordinated cash bonds.

Recommended bond portfolio duration: 4.25 years

Reduce investment-grade and sovereign emerging-markets bonds, increase EU peripheral bonds and cash position.



Source: ABN AMRO Private Banking

Currencies

Growth currencies in the lead

Group Economics

Georgette Boele – Coordinator FX and Commodity Strategy

US dollar as a growth currency

We believe that the US dollar will be the top performing G4 currency in 2013 and 2014, based on an improvement in the US growth outlook, attractive returns on US assets and the growing expectations of an exit in 2014 by the Federal Reserve from its loose monetary policy.

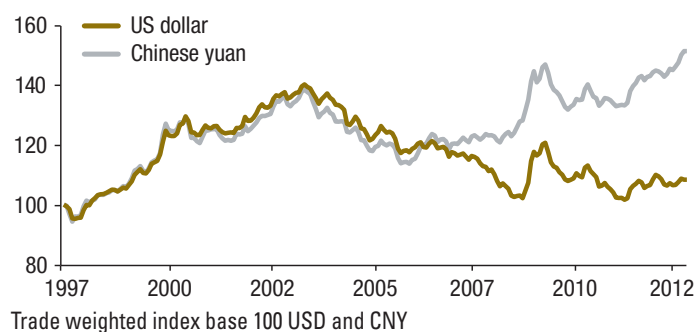
The dollar used to fall on the unwinding of safe-haven demand. It is now strengthening on the view that US assets will generate higher returns. This is reflected by the correlation between the US dollar and the Chicago Board Options Exchange Volatility Index (VIX) turning negative and the correlation between the greenback and US equity markets becoming sharply positive. This adds to our view that the relative strength of the US economy over the coming quarters will drive the dollar higher against other advanced-economy currencies. In 2014, expectations of Fed rate hikes in 2015 should lead to broad-based dollar strength. An improvement in the US fiscal deficit and current account also adds significant fundamental support.

Asian top pick: Chinese yuan

The exchange rate of the Chinese yuan is largely determined by local authorities through the fixing rate. The currency is allowed to trade within a 1% trading band relative to this rate. Recent government plans to unveil a road map of the internationalisation of the currency has led to increased optimism. We believe that it is likely that the trading band will be widened from 1% to 2% in the coming year, as the government gradually allows the yuan to be more market driven.

But rising hot capital flows, due to gushing global liquidity, remains an immediate concern for Chinese authorities. Regulations to limit the net open foreign-exchange positions of banks and to curb shadow banking have also been implemented. We therefore doubt that further liberalisation of the yuan trading band will be introduced before these concerns abate. We remain positive on the Chinese yuan for the coming two years, given its attractive valuation, China's current account surplus, the country's strong economic performance relative to the world and attractive yield. We expect the Chinese yuan to appreciate against the US dollar towards 6.05 in 2013 and 5.80 in 2014.

Effective exchange rate US dollar and Chinese yuan



Source: BIS, Bloomberg, ABN AMRO Group Economics

Asset class	Fundamental view	Recommendations
Currencies	Positive on the US dollar, based on improving economy, asset prices and Fed exit from accommodative policy.	Accumulate USD above 1.30 against EUR.
	USD and CNY as growth currencies (Positive).	G4 top pick: USD.
	EUR as interest rate-sensitive currency (Neutral).	European top picks: SEK, PLN.
	JPY and CHF as fading safe havens (Negative).	
	Modestly positive on Asian FX.	Asian top pick: CNY.

Forecasts

Go as far as you can see;
when you get there
you'll be able to see farther.
Thomas Carlyle

Research & Strategy
and Group Economics

Our central scenario is based on the conviction that a global cyclical recovery will progressively gather pace in a low inflationary environment into 2014, led by the US and the positive contribution of Japan and fast growing countries. The eurozone will lag, but the peripheral countries will start to bottom out. The months ahead may be characterised by a

wave of positive forecast revisions from official and private agencies following the downward revisions. These economic forecast revisions, and, in particular, those from the Federal Reserve Board would augur a less accommodative monetary policy.

Macro indicators (%)

5 June 2013	Real GDP Growth 2014		Inflation 2014	
	ABN AMRO	Market view	ABN AMRO	Market view
US	3.2	2.7	1.8	2.0
Eurozone	1.3	0.9	1.1	1.6
UK	1.8	1.6	2.0	2.5
Japan	2.1	1.5	1.6	1.9
Other countries*	2.8	2.6	2.1	1.8
Em Asia	6.7	6.8	4.7	4.4
Latin America	4.2	3.8	7.8	6.5
EEMEA**	3.1	3.6	4.8	5.6
World	4.0	3.8	3.7	3.5












All forecasts are annual averages of quarterly year-on-year changes.

* Australia, Canada, Denmark, New Zealand, Norway, Sweden and Switzerland

** Emerging Europe, Middle East and Africa

Source: ABN AMRO Group Economics, Consensus Economics, EIU

Equity indexes

	Spot 5 June 2013	Active strategy	Forward P/E 2014
MSCI ACWI	366.9		12.3
S&P 500	1640.4		13.4
Euro Stoxx 50	2756.7		10.6
FTSE-100	6559.4		11.1
Nikkei 225	13533.8		17.0
DAX	8308.4		10.8
CAC 40	3928.3		10.9
AEX	361.1		11.0
Hang Seng Index	22285.5		9.7
Shanghai SE Comp.	2272.4		8.7
Straits Times Index	3291.4		13.5

 = Underweight  = Overweight  = Neutral

Interest rates and bond yields (%)

	5 June 2013	Sep 2013	Dec 2013	Mar 2014	June 2014
United States					
US Fed	0.25	0.25	0.25	0.25	0.25
3-month	0.27	0.3	0.3	0.3	0.5
2-year	0.3	0.3	0.4	0.5	0.6
10-year	2.14	2.1	2.5	3.0	3.25
Germany					
ECB Refi	0.5	0.5	0.5	0.5	0.5
3-month	0.2	0.2	0.2	0.2	0.4
2-year	0.1	0.2	0.4	0.6	0.7
10-year	1.54	1.5	1.8	2.1	2.6

Currencies

FX pair	5 Jun 2013	Sep 2013	Dec 2013	Mar 2014	Jun 2014
EUR/USD	1.3072	1.25	1.20	1.20	1.15
GBP/USD	1.5347	1.49	1.45	1.45	1.40
EUR/GBP	0.8519	0.84	0.83	0.83	0.82
USD/CHF	0.9455	1.00	1.08	1.08	1.13
EUR/CHF	1.2367	1.25	1.30	1.30	1.30
USD/JPY	99.57	106	110	112	115
EUR/JPY	130.14	133	132	134	132
USD/CAD	1.0340	1.00	1.00	1.00	1.00
AUD/USD	0.9563	0.90	0.90	0.90	0.90
NZD/USD	0.7987	0.76	0.76	0.76	0.76
EUR/NOK	7.6127	7.50	7.50	7.50	7.50
EUR/SEK	8.6321	8.25	8.00	8.00	7.75

Hedge funds

Effective diversifiers

Research & Strategy

Olivier Couvreur – CIO Multimanager Hedge Funds

Erik Keller – Senior Hedge Fund Analyst

Hedge fund strategies currently offer diversification and risk reduction opportunities for a wide range of portfolios. These benefits apply to defensively positioned fixed income allocations as well as to more offensively positioned equity allocations. We maintain our recommendation for an overweight hedge fund allocation.

Diversified hedge funds can reduce risk in defensive portfolios

Current low (or negative) yields on fixed-income investments provide little compensation for the increased interest-rate risk to which bond investors are exposed. Diversified funds of hedge funds, however, have demonstrated that they can generate solid returns with low volatility, no matter if bond markets go up or down. The current environment offers a wide range of opportunities for these funds, driven, for example, by corporate restructurings, mergers & acquisitions (M&A) or fundamental stock-selection strategies, where equity-market risks are partly or fully hedged. By emphasising diversification, these funds can produce a superior risk/return profile in the current market environment (see graph).

Another strategy for defensive investors are long/short bond funds, which have the flexibility to invest in government bonds, investment-grade and high-yield credits, emerging-market debt and senior secured bank loans. These funds can also profit from shorting corporate bonds and by hedging interest-rate and credit risks.

Long/short equity funds can lower risk in offensive portfolios

Equity investors and those with a more offensive outlook should consider long/short equity (funds of) funds, because of their higher risk/return profile (compared with diversified funds of funds), and their ability to reduce equity-market risks. In response to current market conditions, for example, long/short equity funds have recently reduced risk by lowering their net market exposure.

A broad range of long/short equity strategies are benefiting from today's favourable stock-picking environment. Equity market-neutral funds, long/short equity funds with flexible market exposure, sector-focused long/short equity funds and more general long/short equity funds have all performed well recently.

We expect market fundamentals to remain supportive for long/short equity strategies, with returns coming primarily from stock selection in both the long and short portfolios.

Hedge fund strategy recommendations

Positive on long/short equity and event-driven

Neutral on relative value

Negative on global macro/commodity trading advisors (CTA)

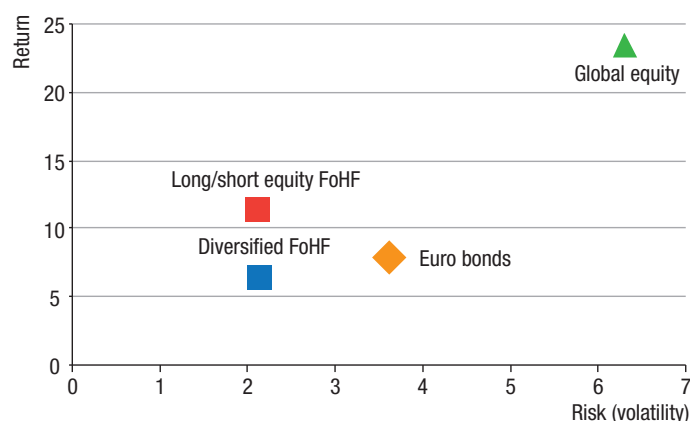
Long/short equity: As equity markets have rallied, we prefer a slightly more prudent stance, emphasising variable-biased and market-neutral long/short equity funds over pure long-biased funds.

Event-driven: The positive rating is based on an expected increase in M&A and the opportunities in special situations, such as activist positions and corporate restructurings.

Relative value. Although we expect more dispersion in performance across credits, which is typically positive for long/short credit managers, we believe that other hedge fund strategies offer more return potential.

Macro/CTA (managed futures): CTA returns have been uneven. Given the long risk positions, we think Macro/CTA strategies offer less diversification potential in the current environment.

Comparative one-year risk and returns in %



Source: Lipper Hindsight, data period: 31 May 2012 – 31 May 2013

Commodities

A bearish outlook for Q3

Group Economics

Hans van Cleef – Energy Economist

Georgette Boele – Coordinator FX and Commodity Strategy

The super cycle is over. Softer economic data from the US and China have depressed commodity prices, especially cyclical commodities, such as oil, base metals and most precious metals. We expect sentiment to recover, however, in the coming weeks and months, based on an improving US economy, which is expected to pick up in the second half of 2013.

The recovery, in both the US and China, supports cyclical commodities with a relatively tight supply-demand balance. The fundamentals for copper and some precious metals, for example, are solid. But overall demand growth for base metals is lower, with overcapacity in aluminium and steel a concern.

Bear market for gold and silver outlook negative

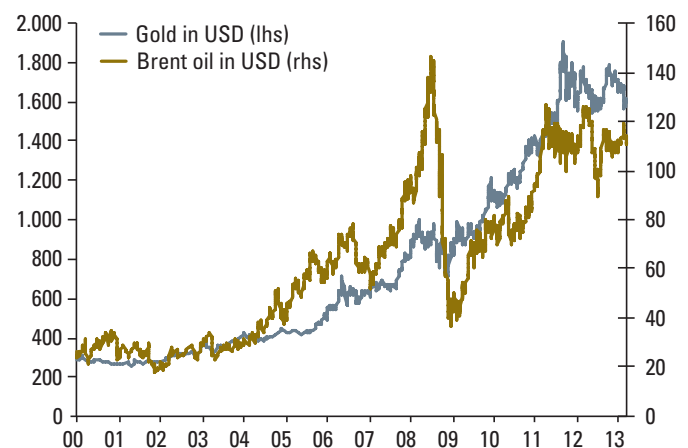
Gold is in a bear market. We expect prices to decline to USD 1,300 by the end of this year, to USD 1,000 a year later and to USD 800 by the end of 2015. The outlook for silver remains negative in the near term as well, affected by the poor sentiment for gold. But later in 2013 and in 2014, the demand for industrial silver could improve, laying a floor under silver prices.

Oil to trade in a narrow range

Although oil supply remains abundant, hopes of an increase in demand will keep prices within a narrow trading range for the next three months. We continue to expect a moderate decline in oil prices in the longer term, based on the assumption that the new supply in global output will outpace demand.

Gas prices in the UK and eurozone are currently trading higher. This is due to increased heating demand because of below normal temperatures. In the US, gas prices could continue to track upward due to cooling and airconditioning demand. This will partly prevent stock building, but it also lowers the likelihood of our base case scenario of easing US gas prices.

Gold and oil: life after the tops 2000 - 2013



Source: Bloomberg

Asset class	Fundamental view	Recommendation
Commodities Neutral	Negative view on the Commodity Research Bureau Index for Q3, driven by less favourable specific commodity fundamentals such as higher supply and a higher US dollar.	Neutral exposure in broad indexes for diversification and insurance.

Property

Temporary correction,
fundamentals unaffected

Research & Strategy

Manuel Hernandez Fernandez – Property Specialist

The property sector has generated acceptable returns, ranging from 5-8%, since the beginning of the year. An appetite for yield has driven markets and valuations for listed real estate investment trusts (REITs) upwards. It has not been a smooth ride, however, as there have been bouts of profit-taking along the way. This has occurred particularly among the most expensive listed property names in the US and Asia (mostly Japan). Nonetheless, we are convinced that the relatively higher valuations remain justified for quality listed companies in the US.

Financing advantages

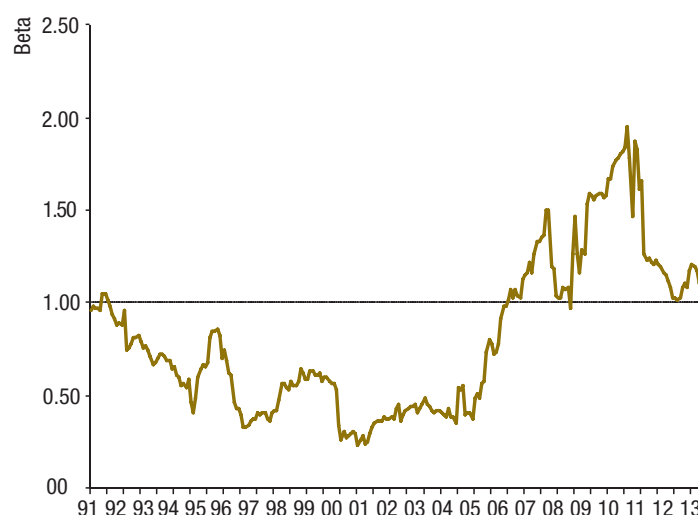
The accommodative monetary policy of the past few years has provided many listed property companies with financing advantages. They have benefitted from locking in low rates for the long term. And the combination of attractively priced debt and strong equity valuations has also translated into opportunities for external growth through acquisitions. Lower rates have also enabled many property companies to reduce debt and improve leverage ratios. Since 2008, leverage ratios have declined from around 80% to a more healthy 50%. The main reason is access to different sources of financing, including non-bank debt. With the decline in leverage, the sector's sensitivity to equity markets has also decreased, although it remains high. (See graph.)

Fundamentals remain strong

With commercial real estate demand closely linked to economic growth, expectations for an accelerating global recovery is positive for sector fundamentals, including occupancy rates, rents and tenant turnover. This is particularly true for the high-quality real estate portfolios of the US REITs, i.e. offices and industrials, that we favour.

The underlying business case for investing in real estate remains positive, based on an attractive dividend yield of 3.5%, built-in protection from inflation and strong balance sheets. Even in an environment where rising interest rates are beginning to be expected, we believe the sector's fundamentals will continue to support growth. And, for many listed companies, rising inflation has already been factored in, owing to inflation-linked rental agreements.

Sensitivity of US listed real estate to MSCI North America Index



Source: Petercam

Sensitivity is measured by rolling beta. A beta higher than one indicates a greater sensitivity, a beta lower than one indicates lesser sensitivity to the stock market.

Asset class	Fundamental view	Our recommendations
Property Neutral High-quality property fits the bill for yield, low leverage, cash flow and limited new supply. There are also accumulating signs of a turning point in the US housing market and support from the authorities in developed Asia.	US REITs: Subsector rotation favours cyclical-tilted REITs. Asia: Preference for developed Asian markets over emerging Asian markets. Although tightening could still occur, we forecast robust developer sales and stable residential prices. Europe: Given the challenging operating environment, we favour top-tier companies owning the best properties in the best locations. These stocks are trading at premiums to net asset value.	Overweight: North America Neutral: Asia Underweight: Europe

Private equity

Opportunities as the industry evolves

Research & Strategy

Olivier Palasi – Head Private Equity

It is a challenging period for private equity. Longer holding periods are delaying exits and the availability of capital for new investments. But it is not all bad news. A range of buyout opportunities is seen in France, Germany, the Nordic countries and Spain.

Longer holding periods hurt future commitments

The average holding period of companies in private equity portfolios is becoming much longer than either general partners or investors had ever anticipated. For example, the holding period for Asia-based portfolio companies has increased dramatically from 2.6 years in 2007 to 4.7 years today. And it is the larger deals, (i.e., more than USD 1 billion) that are most affected by this trend.

The delay in the exiting process has knock-on effects. It upsets the mechanism of committing new private equity funds (see graph). In the absence of cash distributions generated from company sales, certain types of investors may find it difficult to make new commitments. This, in turn, creates an imbalance between deep-pocketed institutional investors and others in a fund. As a result, many investors are likely to reduce their commitments – or at least postpone their investment decisions.

One industry response may be to use refinancing as a way to distribute cash to investors. Even if many partnerships were considering this pre-exit solution, however, the lengthening of holding periods appears to be risky when all value has already been added in.

Fund raising presents challenges

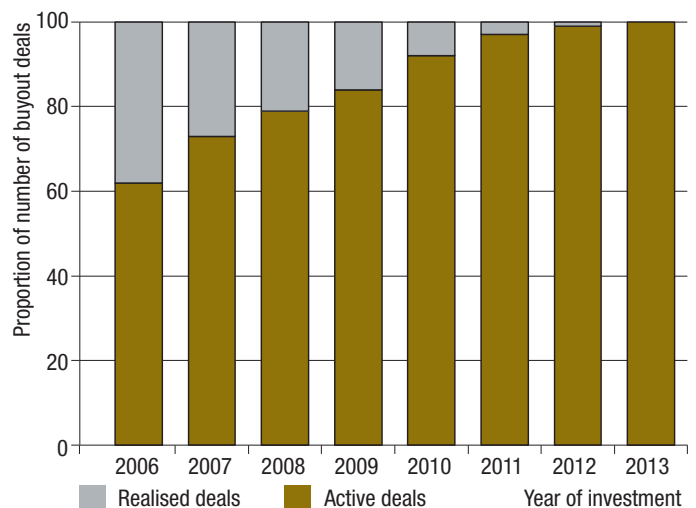
Certain managers are also encountering difficulties with fund raising. While this is not a problem for managers with a clear investment strategy and proven track record, for those that do not have these attributes, attracting capital from limited partners may be daunting.

The importance of a track record is seen with infrastructure funds. Increasing demand for infrastructure development around the world is fuelling private equity funds dedicated to these segments. But with few investment managers showing a history of investment, availability remains limited. Another impediment to the infrastructure asset class is that it has been split into various sub-strategies, making the sector much more complicated for investors.

Regional opportunities

We see attractive, but selective, opportunities in private equity investment throughout Europe. For example, while the United Kingdom remains the largest and most competitive buyout market, not all industry sectors are sought after. In France, Germany, and the Nordic countries, global industrial companies will have to sell non-core businesses in the years to come. The decision process regarding these deals, however, will be long. Germany offers a range of industrial companies that could become global players within two to three years of added-value activity. And Spain may appear to be an Eldorado of sorts, due to corporate and stressed sellers being unable to find refinancing. In addition, assets owned by Spanish banks are beginning to come to the market. The Italian market is also suffering. The quest for liquidity by family sellers has led to deal flow for strong exporting companies.

Private-equity portfolio companies currently held by year of investment



Source: Preqin

Performance and risk

Anticipating changes

Research & Strategy

Hans Peters – Head Investment Risk
Emilia Bruera – Investment Risk Specialist

Asset allocation: selective positioning and risk mitigation

The current asset allocation has been adjusted in order to mitigate market volatility. Bond positions have therefore been reduced (Investment Grade and Sovereign Emerging Markets) to a further underweight, the equities overweight has been scaled back, and real estate was reduced, allocating the proceeds to cash. Diversification remains key: hedge funds are neutral in the central profiles (3 and 4) and underweight in equity-driven profiles (5 and 6).

Risk vigilance via option markets

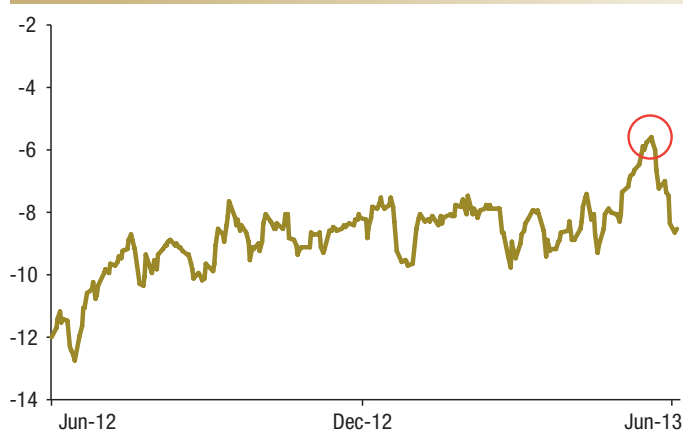
Stock markets rallied and reached new record highs, leading to an increase in the demand for speculative call options (see graph). Thus, the difference in volatility between a call protecting against a 10% increase versus a put protecting against a 10% drop on the S&P 500 Index climbed to the highest point since 2005. With the Fed signalling the termination of open-end stimulation, and the ensuing equity decline, this indicator has retreated to previous levels. As a quantitative measure of greed versus fear, this is a valuable indicator of market sentiment, especially if it deviates strongly from historical levels. The option market is a useful tool to monitor the fragilities of the markets and is integrated into our risk monitoring.

Performance: A positive H1 2013

During the first half of the year we have seen positive returns for equities, except emerging markets, as well as for property

and hedge funds. The performance in all our profiles since 1 January 2013 has been positive, outperforming the benchmark in all profiles except in profile 6 in EUR and USD, due to the impact of emerging markets equities, and profile 1 in EUR, due to the limited returns in cash and the poor performance of emerging market bonds.

Difference in three-month implied volatility



Call minus put on S&P 500 protecting for an up and down 10% market change respectively

Source: Bloomberg

Audited performance of our Tactical asset allocation vs. its Strategic asset allocation

	EUR						USD					
	22 May 2003 to 30 May 2013*			2013 YTD (30 May 2013)			22 May 2003 to 30 May 2013*			2013 YTD (30 May 2013)		
	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return	Strategic	Tactical	Excess Return
Profile 1	56.25	66.58	6.61	1.67	1.36	-0.31	53.67	69.07	10.02	-0.16	0.32	0.49
Profile 2	60.30	72.08	7.35	3.15	3.53	0.37	60.99	76.51	9.64	1.71	2.78	1.05
Profile 3	76.92	99.86	12.96	4.53	5.23	0.67	83.17	105.56	12.22	3.44	4.76	1.28
Profile 4	82.16	105.32	12.71	6.39	7.04	0.61	92.33	112.98	10.74	5.77	6.96	1.13
Profile 5	93.20	120.28	14.01	8.27	8.43	0.15	106.43	129.58	11.22	8.13	8.64	0.47
Profile 6	97.41	123.59	13.26	9.70	9.38	-0.29	113.69	134.27	9.63	9.92	9.79	-0.12

* Profiles 1 and 2 are linked to the "old" Conservative profile, profiles 3 and 4 to the "old" Balanced profile and profiles 5 and 6 to the "old" Growth profile.

Asset allocation

Let our advance worrying become
advance thinking and planning.
Winston Churchill

Global Investment Committee Private Banking

ABN AMRO's Global Investment Committee model portfolios showing EUR/USD risk profiles in %, starting with our most conservative (Profile 1) and ending with that most exposed to market risks (Profile 6).

Profile 1						Profile 2				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	60	31	+26	5	0	70	17	+12
Bonds*	90	40	100	61	-29	70	30	85	49	-21
Equities	0	0	10	0		15	0	30	21	+6
Alternative investments	5	0	10	8	+3	10	0	20	13	+3
Funds of hedge funds	5			8	+3	5			8	+3
Real estate	0			0		3			3	0
Commodities	0			0		2			2	0
Total Exposure	100			100		100			100	

Profile 3						Profile 4				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	70	13	+8	5	0	70	13	+8
Bonds*	55	20	70	37	-18	35	10	55	19	-16
Equities	30	10	50	40	+10	50	20	70	58	+8
Alternative investments	10	0	20	10	0	10	0	30	10	0
Funds of hedge funds	5			5	0	5			5	0
Real estate	3			3	0	3			3	0
Commodities	2			2	0	2			2	0
Total Exposure	100			100		100			100	

Profile 5						Profile 6				
Asset class	Strategic			Tactical	Deviation	Strategic			Tactical	Deviation
	Neutral	Min.	Max.			Neutral	Min.	Max.		
Money markets	5	0	70	6	+1	5	0	60	5	0
Bonds*	15	0	40	9	-6	0	0	25	0	
Equities	70	30	90	80	+10	85	40	100	90	+5
Alternative investments	10	0	30	5	-5	10	0	30	5	-5
Funds of hedge funds	5			0	-5	5			0	-5
Real estate	3			3	0	3			3	0
Commodities	2			2	0	2			2	0
Total Exposure	100			100		100			100	

*Recommended duration: **Neutral**. Benchmark: Bank of America, Merrill Lynch Government Bonds 1-10 years.

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Editorial Support

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