

Allocation Recommendation

4 May 2017

Market Outlook Summary

Stocks continued to climb in April following a strong first quarter. European equities were doing particularly well, supported by a good earnings season and lower political risk. The first round of the French presidential election was uneventful and credit risk premiums shrank clearly throughout the asset classes.

Companies are currently reporting their Q1 earnings. Earnings have proven to be a positive surprise in the US, Europe and the Nordic countries alike. In Europe, the equity markets have risen clearly and, thanks to the strengthening of the euro, the European equity markets have finally yielded better than the US main markets as of the beginning of the year. Investments continue to flow towards equities and fundamentals in Europe also favour the positive approach on the markets.

Interest rates continue to fluctuate in Europe driven by the political risk premium and, on the other hand, strengthened economic development and thus higher inflation expectations. The interest rate on Germany's 10-year government bond has fluctuated between 0.17% and 0.45%. According to our insight, interest rates have passed rock-bottom in the euro zone. The ECB has not yet been willing to give the markets leave to factor interest rate hikes into forecasts and has communicated very little on the timing of the winding down of the QE programme. We predict, however, that with positive economic development and rising inflation, the ECB will announce late in the year the schedule according to which it will begin to reduce its purchases of secondary market bonds.

Changes in Recommendations

We are not changing our allocation recommendation coming into May. We will maintain our neutral allocation recommendation for equities and fixed income. Correspondingly we will maintain our moderate overweight recommendation for alternatives.

Within equities, we will maintain European companies in moderate overweight and our moderate underweight recommendation for US equities. Macro figures have strengthened but market expectations in the US in particular are at such high levels that real economy figures have not quite managed to reach forecasted levels during the past month. Uncertainty concerning the materialisation of Trump's tax cuts has increased since no agreement has been reached concerning the budget deficit or its sources.

We will continue to focus on corporate bonds within fixed income investments. We will maintain lower risk investment grade bonds and higher risk high yield bonds and secured senior loans at moderate overweight. Similarly, we will maintain our recommendation for European government bonds and emerging fixed income markets at underweight.

We will not make any changes in our alternative investment recommendation. We are maintaining our recommendation for private debt at moderate overweight. The amount of cash in European private debt funds appears to be even smaller than around the same time a year ago. In the big picture, due to a low interest rate level, returns offered by alternative investments are relatively attractive to investors for whom limited liquidity is not a problem. Money flows are expected into alternative investments in the medium term when investors seek alternatives for low-yield fixed income investments.



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Asset classes <i>(Applicable investment basket)</i>	Underweight	Moderate underweight	Neutral	Moderate overweight	Overweight	
Fixed income <i>ML Fixed Income Portfolio Abs</i>			Maintained			We will maintain fixed income investments at neutral weight. Economic forecasts have strengthened further and the confidence of companies and consumers, among others, has improved. In the US the Fed is expected to remain on its interest rate hike path and in Europe the ECB has reduced its stimulus measures. We predict that, after the summer, the ECB will have an opportunity to review the future of its QE programme, which would accelerate the rise in interest rates. The rising interest rate level highlights the need for active interest rate risk management in fixed income investments.
Equities			Maintained			We will maintain equities at neutral weight. The rise in equity markets, particularly in the US, has increased valuation levels and, also in Europe, equities are priced higher than the historical average. The equity markets are supported by strengthening corporate earnings and a slight improvement in global economic growth. Globally, money continues to flow towards the equity markets.
Alternative Investments				Maintained		We will maintain alternative investments at moderate overweight. Due to a low interest rate level, returns offered by alternative investments are relatively attractive to investors for whom limited liquidity is not a problem. Money flows are expected into alternative investments in the medium term when investors seek alternatives for low-yield fixed income investments.

Fixed Income <i>(Applicable investment basket)</i>	Underweight	Moderate underweight	Neutral	Moderate overweight	Overweight	
Money Markets, Europe <i>ML Money Abs</i>			Maintained			We will maintain money market investments, i.e. short-term investments, at neutral weight. Given the current low interest rates, the money markets do not produce yields in excess of the inflation rate. The price risk in money market investments is very low, however. In our allocation recommendation, money market investments mainly serve as a temporary 'deposit box'.
Government Bonds, Europe	Maintained					We will maintain government bonds at underweight. Due to a low interest rate level, rising due to an improving macro picture, return opportunities are few. In Europe, the interest rate level at the end of April was higher than at the start of the year and the trend is still slightly ascending. The yield level of Germany's 10-year government bond, which bottomed out at -0.2%, rose to around +0.3% at the end of April. The interest rate differential between France, Italy and Spain compared to Germany has grown slightly this year due to political uncertainty.
Corporate bonds, investment grade				Maintained		We will maintain low-risk investment grade corporate bonds at moderate overweight. In the United States, the credit risk premiums of investment grade bonds were at a higher level than in Europe. As of the start of June, the ECB has also purchased low-risk corporate bonds, which has brought down the yield level on European bonds. It pays, however, to be selective in the current environment and to hedge actively against interest rate risk.
Corporate Bonds, high yield <i>ML Nordic High Yield Abs ML Euro High Yield</i>				Maintained		We will maintain high yield corporate bonds in moderate overweight. The low interest rate level is steering investors to seek returns in riskier alternatives, which is also leading to increased demand on the high yield market. On the European high yield market, yield levels have fallen to a very low level. The Nordic countries currently offer higher yield potential, for example, the running yield of the ML Nordic High Yield investment basket is at around 6.7%. We thus see value especially in select Nordic names.
Emerging market debt <i>ML Emerging Markets Bond Index</i>	Maintained					We will maintain emerging fixed income markets at underweight. Higher raw material prices have improved the outlook for many emerging countries. Inflation expectations have risen due to the rise in raw material prices. We favour bonds listed in local currencies.
Senior Loans				Maintained		We will maintain secured senior loans at moderate overweight. The yield level on European senior loans has tightened along with the rest of the market. However, in the current environment the floating rate coupon, which hedges against rising interest rates, favours investing in senior loans. The liquidity of senior loans is lower than that of listed bonds, which means that investors must be ready to tie down their assets for a longer period.

The weights describe our recommendation in relation to each investor's investment plan's balanced situation.



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Equities	Underweight	Moderate underweight	Neutral	Moderate overweight	Overweight	
(Applicable investment basket)						
Developed markets <i>ML Future Climate</i>			Maintained			We will maintain developed markets at neutral weight. Generally speaking, the valuation factors of equities exceed the long-term median, but companies' earnings forecasts are rising in key markets and key confidence indicators are strong. In the US and Europe monetary policy is moving along a tightening path while Japan is carrying on with its highly expansionary policy. Emerging market equities continue to offer attractive return potential, particularly against the low and rising interest rate level.
Europe, large caps <i>ML Europe Equity</i>				Maintained		We will maintain major European companies at moderate overweight. Economic data is strengthening. The valuation level is above the long-term median but companies' strengthening corporate earnings support equities. Due to the rise in interest rates, the depression of banks is easing up and money is also flowing into other cyclical sectors. In addition to central bank news, political risk is another factor possibly increasing share price volatility.
Europe, SMEs <i>ML European Small & Mid Cap</i>				Maintained		We will maintain our moderate overweight recommendation for European SMEs. The growth outlook for small cap companies is better than for large cap companies, and domestic markets account for a bigger part of small cap companies' turnover, which is why they are better positioned than large cap companies to benefit from an economic pickup. Valuation levels are more moderate due to improved earnings power. However, active portfolio management is all the more important with regard to small cap companies.
Finland <i>ML Finland Index</i>			Maintained			We will maintain Finland in neutral weight. The weakened euro and Europe's slightly recovering economic growth offer export companies a much-needed push. Earnings growth forecasts have remained stable, but the valuation level is slightly above the historical average.
Scandinavia <i>ML Nordic Equity</i>				Maintained		We will maintain Scandinavia in moderate overweight. The valuation level is slightly above the historical average but earnings growth forecasts are on their way up. The strengthening of the Swedish krona through the central bank's interest rate hikes would improve euro-denominated returns. Discerning investors can find opportunities in specific industries and in individual companies.
United Kingdom <i>ML United Kingdom Index</i>		Maintained				We will maintain the UK at moderate underweight. The Brexit process creates uncertainty, which is likely to limit companies' investment appetite. However, key confidence indicators have remained at a good level and earnings growth forecasts are on the rise. A weakened pound has also boosted exports and diminished the trade deficit. The valuation level of the equity market is above the historical average.
USA <i>ML USA Index</i>		Maintained				We will maintain the United States in moderate underweight. Economic data continues to be strong and earnings growth expectations have risen, but the valuation level is, however, above the historical median and higher than in Europe, for example. Uncertainty concerning the materialisation of Trump's tax cuts has increased since no agreement has been reached concerning the budget deficit or its sources. Similarly, increases in infrastructure expenditure are still uncertain. Uncertainty is being maintained, in addition, by a possible shift towards a protectionist trade policy.
Japan <i>ML Japan Index</i>	Maintained					We will maintain Japan in moderate underweight. The valuation level on the equity markets is above the historical average but the earnings development of companies has been weak despite massive stimulus measures. In the long term, Japan's biggest challenge is its ageing population.
Australia <i>ML Australia Index</i>		Maintained				We will maintain Australia in moderate underweight. As a raw-material-based economy and due to its location, Australia will benefit in the long term from the growth in Asia. Especially the Australian gas industry is growing as China's demand continues to rise. Earnings growth forecasts have risen slightly due to higher raw material prices. The valuation level is above the historical average, however.
Emerging markets <i>ML Emerging Markets Equity</i>			Maintained			We will maintain emerging markets in neutral weight. A strong dollar, which increases the price of dollar-denominated financing for companies, and Trump's potential planned trade restrictions are maintaining uncertainty. Different markets find themselves in very different situations as raw material prices and geopolitics, among other things, affect countries in very distinct ways. The valuation levels of equities are cheaper than on the Western markets but, despite uncertainties, price momentum has been positive.
Russia <i>ML Russia Index</i>		Maintained				We will maintain Russia at moderate underweight. Russia's economy is burdened by the EU's sanctions and Russia's counter-sanctions. The rise in the oil price has, however, reflected positively on the equity markets. The valuation level has risen but, at the same time, earnings forecasts have also begun to rise. Geopolitical tensions are preventing the starting up of foreign investments, which are essential for long-term economic growth.

The weights describe our recommendation in relation to each investor's investment plan's balanced situation.

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Equities						
<i>(Applicable investment basket)</i>		Underweight	Moderate underweight	Neutral	Moderate overweight	Overweight
Brazil and Latin America				Maintained		
<i>ML Brazil Index</i>						
<i>ML Latin America Index</i>						
China					Maintained	
<i>ML China Index</i>						
India			Maintained			
<i>ML India Index</i>						
Indonesia				Maintained		
<i>ML Indonesia Index</i>						
Frontier Markets			Maintained			
<i>ML Frontier Markets Index</i>						
Alternative Investments						
<i>(Applicable investment basket)</i>		Underweight	Moderate underweight	Neutral	Moderate overweight	Overweight
Private debt					Maintained	
Convertible bonds					Maintained	
<i>ML Convertible</i>						
Real Estate					Maintained	
Commodities				Maintained		
Gold				Maintained		
<i>ML Gold Index</i>						

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