

Market Outlook

February 2011

Dramatic price ascent in commodity markets

Strong sector rotation in western stock exchanges as well as profit booking from last year's winners played the main role in financial market in January. Last year's losers up kept the strong ascent in Europe and also in the US, investors turned around their portfolios at such a speed, at the beginning of the year, that a similar negative correlation between main sectors has not been seen in a decade.

We have been relatively careful with equity risk and are maintaining our neutral allocation entering February. The strong stock price ascent of Southern European banks lifted the EuroStoxx 50 index from the beginning of the year in January, but the vaster Stoxx 600 index fell behind the US S&P500 index. Many of last year's best performing stock exchanges have turned to negative figures due to the tightening measures of EM central banks, investment flow turning to western exchanges and margin pressures (India, Indonesia, Thailand etc.). We maintain moderate underweight in fixed income markets and moderate overweight in alternative investments.

In European fixed income markets, the underlying German government bonds and swap rates continued to climb slightly upwards. The ECB speeded the leveling of

the yield curve as shorter yield levels rose more, when it indicated the raising of its state of readiness to battle inflation. Markets currently price the first interest rate hike to be in August-September this year. We view the schedule to be slightly presumptuous in light of the prevailing information.

The tightening of European Border States bond yield spreads against Germany made the ECB to even slightly moderate its government bond repurchasing program. Europe's Stabilization Fund auctioned its first loan in markets and demand was strong especially from Asian countries. Also the banking sector stocks recovery in Southern countries supported the government bond market on its part, but an "all clear flagging" is not yet called for. The restructuring and cutting of capital of Greek bonds would signify dark news for German and French banks.

We maintain our neutral stance in equities entering February. We are booking profits from EM equities and moving weight to Europe and the US, though keeping the US at relative overweight to Europe. Russian markets are supported by oil and raw material price rises, but many EM markets have performed poorly since the year beginning. We maintain relative

weight on Russia within EM equities currently. In the Nordics, stock exchanges have bowed down at the beginning of the year, though Finland still bears a plus sign. The earnings season for last year is now ongoing and mainly earnings improvements have not lived up to consensus forecasts and stock price disappointments have been even great. The possible weakening of earnings margins due to strong rises in producer prices is a significant factor in equity market sentiment this year and we are following guidance closely.

The rise in food prices was the last straw in the MENA area (Middle East & North America), causing protestors to occupy streets in Egypt and prevailing regimes to be changed in many countries. The possible increase in escalation of political risk will raise commodity prices further at the beginning of the year. New fundamental info on agricultural commodity direction will only be received in the form of the next crop statistics, thus the volatile environment in derivative markets will continue. We lower commodity weight in alternative investments, especially in agricultural commodities. We otherwise maintain our moderate overweight recommendation in alternative investments.

Market Returns 31.1.2011

Fixed Income	Return 1m	Return 2011	Return 1y
JPM Money Mkt	0,10 %	0,10 %	1,12 %
JPM EMU Govt	-0,38 %	-0,38 %	0,31 %
Barcleys Infl.Linked	0,36 %	0,36 %	2,29 %
JPM Credit Index	-0,60 %	-0,60 %	2,51 %
JPM High Yield	2,64 %	2,64 %	14,75 %
JPM GBI EM Divers. (LC)	-4,15 %	-4,15 %	15,17 %
JPM EMBI+ (HC)	-0,49 %	-0,49 %	11,32 %

Equity Markets	Return 1m	Return 2011	Return 1y
OMXH Mid Cap	1,85 %	1,85 %	20,60 %
Euro Stoxx 50	5,22 %	5,22 %	6,37 %
Stoxx 600	1,09 %	1,09 %	13,40 %
S&P 500	2,25 %	2,25 %	19,76 %
Dow Jones	2,79 %	2,79 %	18,12 %
Nasdaq	1,39 %	1,39 %	25,74 %
Nikkei	0,09 %	0,09 %	0,39 %
Hang Seng	1,95 %	1,95 %	16,53 %
India	-10,11 %	-10,11 %	12,04 %
Russia (RTS)	5,65 %	5,65 %	26,90 %
Brazil	-3,94 %	-3,94 %	1,79 %
MSCI Europe	1,16 %	1,16 %	13,09 %
MSCI World	1,39 %	1,39 %	18,13 %
MSCI Emerging Markets	-2,24 %	-2,24 %	22,48 %
MSCI Latin America	-4,19 %	-4,19 %	17,41 %
MSCI Eastern Europe	4,40 %	4,40 %	16,29 %

Alternative Investments	Return 1m	Return 2011	Return 1y
S&P Commodity TR	4,71 %	4,71 %	21,98 %
Oil (spot)	1,65 %	1,65 %	17,31 %
Gold (spot)	-5,23 %	-5,23 %	22,34 %
HFRX Global HF	0,94 %	0,94 %	5,25 %

Foreign exchange	31.1.2011	30.12.2010
EURUSD	1,369	1,329
EURJPY	112,34	108,330
USDJPY	82,04	81,530
EURGBP	0,86	0,861
EURSEK	8,83	8,970
EURNOK	7,91	7,822
Interest rate levels		
Fed	0,25	0,25
ECB	1,00	1,00
BoJ	0,10	0,10
BoE	0,50	0,50
Euribor 3m	1,07	1,01
Euribor 12m	1,64	1,51
Germany10y	3,16	2,96
iTraxx Europe 5y (IG)	98,18	105,25
iTraxx Crossover 5y (HY)	415,75	437,48

Fixed Income

Past events

EM turbulence was visible also in local currency sovereign bond markets as negative track at the beginning of the year (JP Morgan LC index -3.4%). Also in currency markets, many EM currencies visibly weakened against the euro and the dollar. EM central banks' monetary austerity measures aim at calming growing inflation pressures, which have turned to be a problem for many EM countries. China's 5% inflation and Indonesia's 7% inflation speak of large EM countries to suffer from the rise in food prices quickly. It appears clear, that many EM country central banks are late in their interest rate hikes and now since a long time, the EM countries are heading the interest rate hike cycle. This is a relatively new phenomenon globally.

Interest rates again in slight ascent

In corporate bond markets, high yield names over-performance against IG names was the prevailing theme in January. Especially forest sector bonds were in good condition and our large weight in these loans yielded well. We have slightly raised weight in longer maturity IG names and we are getting ready to book part of our relative profits on the high yield side.

German government bonds and swap rates showed signs of climbing upwards again. ECB opened a more hawkish tone in light of possible inflation pressures when, in addition to the rise commodity prices, German labor unions have put pressure on the springs' wage negotiations. Derivative markets price the first ECB rate hike for August-September.

Current situation

Corporate leverage loan markets are again hot when investors have barged new issue markets. Floating rate coupon structures and seniority in possible bankruptcy situations relative to the same issues high yield bonds, have kept demand strong also in secondary markets. Many new issues have included "covenant lite" forms used during high leverage years and issues have been overall oversubscribed. Loosened covenants are a familiar phenomenon from the time when additional leverage was sought to portfolios at a time of low yields.

European Border States (PIIGS countries) credit risk premiums relative to interest rate swaps and German sovereign bond yields have

come down during January. For example, Spain's 10-year bond return spread has tightened 0.5% against Germany, only in January. In markets, rotation towards more neutral positioning on the PIIGS countries, after a strong underweighing, has been visible as a strong decrease in risk premiums. The ECB's and European Union's commentary shine contentness on this factor, but yet is not the time to flag the situation to be over. In light of euro area growth, these PIIGS countries limit GDP figures for a long time still. In any case, authorities again have more time to get their reforms through before the stress tests on European banks at the beginning of this year.

Banking sector loans hot again

The future

The divergence of inflation speeds between the G3 area and EM countries we anticipated has proved to be valid, but the turbulence in Arab countries has, of course, come as a surprise. Food's portion in MENA area consumer price basket's is high, around 35-45%, thus the dramatic rise in food prices acted as a catalyst this time. Western countries have a strong interest to up keep stability in the Middle East, but the escalating of geopolitical risk in a possible power void cannot be excluded. In any case, risk premiums may have to raised further in fixed markets. Especially the EMD market in local currencies has been sensitive to revisions after the previous year, and currently many EM currencies have weakened against the euro, leaving an attractive tactical buy-opportunity in this asset class.

Inflation picture continues to diverge between developed and developing markets

In corporate bond markets, we decrease weight in high yield names relative to names with better credit ratings, as high yield over-performance has been very strong. Around the actual 2% realization in credit defaults at the prevailing credit risk premium levels, bode that high yield markets still hold ammo.

In the US, an own "debt crisis" has developed within municipality issues as return spreads rose dramatically. Investors have redeemed funds from muni-bond funds and thus increased market distress. Moody's set its wording so that the whole credit rating of the US may receive the phrase "negative outlooks" in a few years, if the government cannot cut the budget deficit.

Equities

Past events

Very strong sector rotation

The first month of the year was marked by very strong rotation from the sectors that succeeded last year to the weak sectors of last year. The correlation between the main sectors in the US were most moderate in 30 years, which speaks of the market's strong desire to seek returns from companies that, for some reason or other, did not perform well in 2010. In Europe, especially banks from the Mediterranean area rose strongly and Greek, Italian as well as Spanish exchanges were among the climbers of the eurozone since the year-beginning. In addition, eurozone banks have clearly overperformed the general index more than abnks have in the US.

In the Nordic countries, forest companies have overperformed against the general index while cyclical equities have underperformed

strongly. Last year, the rise in pulp price and the beginning developments of consolidation (Myllykoski) as well as the info on rise in prices of final products (mainly newspaper) succeeding have supported the sector.

The EM area pressure downwards in indices has been remarkable as investors have taken down weights quickly as inflation pressures accelerate. Many EM country real interest rates (nominal interest minus inflation) have been very low, and the situation appear to be that central banks are, on average, late with their rate hikes. A too quick interest rate hike cycle is not attainable because EM countries are fighting for export competitiveness and thus want to keep their currency as weak as possible; this spiral of competing for depreciation is a fact.

Current situation

Earning season in the US passed relatively well - some disappointments in the Scandis

Last year's Q4 earnings reporting season is currently ongoing. Up until now, in the US consensus expectations have been beat with a ration of 75/25 with both revenues and the actual results. Industrial names in the US have done well, led by GE, but in Scandinavia, consensus expectations have, in places, been strung so high that the in itself good results have not been enough for markets and stock price reactions have been strongly negative, even though the companies stock prices in question had already fallen 5-10% since the end-of-December peaks.

Especially concerns regarding the pressure downwards of earnings margins are hand touchable in Scandinavia and Finland, where there is reason for caution after the good track of last year. The steady climb of producer prices is visible in SKF, Electrolux etc. as is other margins

pressures relative to market expectations and also on future outlooks.

H&M's stock price development after its earnings release speaks also of pressures of moving producer prices to their final products, which the company has not been able to do. All in all, forecasts have been raised too much in our opinion and now is the time for revision. We continue to be careful with equity weights in Scandinavia and Finland, but hand touchable has especially been the revision in cyclical stocks.

Another feature seems to be that companies want to keep relatively high cash reserves and positive dividend surprises have not come from the Nordic countries, except for maybe Teliasonera, Metso and YIT. It appears that M&A (mergers and acquisitions) opportunities are kept an eye out for, which supports markets.

The future

Focus back on macro after the earnings season

After the earnings season ends, equity market focus will turn back to macro economic news flow. The revival speed of GDP in the US seems to be set and also encouraging messages have come from the eurozone, pulled by Germany. The banking sector in Europe is supported by the rise in interest rates and the steepness of the yield curve, and at the same time a slight timeout has been achieved in the problems of Southern Europe, thus investors are justifiably encouraged to take on risk. In this regard, it would be rare if cyclical equities would continue to underperform for long.

Nevertheless, we maintain equity weight at neutral in light of current information. Especially

when inspecting general risk willingness, in our loop is an investment flow analysis. Volatility priced by equity markets is clearly lower than for fixed income and currency markets, which has caught our attention. We view some to have entered the earnings seasons with slightly too optimistic expectations and we expect companies to again not promise too much regarding 2011 results (similarly to last year), because visibility is still low and companies do not want to instigate overoptimism, which could at worst unravel as profit warnings. We have recently taken note that profit warnings have again come out, and this is an aspect we have not come across much during the last 12 months.

Alternative investments

Real Estate

Regarding real estate, we do not change allocation weight. The possible revision of interest rates upwards in the long term in the G3 area keeps the hottest phase of real estate markets under control, but especially in the US the price development is only lifting off to a rise. One family home prices have risen from their bottom levels and are actually now at a level that has diverged from homebuilders' confidence index level. In any case, commercial real estate markets in the US are showing signs of cheering.

Alternative Investments

We maintain private equity investments allocation weight at neutral. As the IPO market is hot and generally the implementation of private equity deals will further raise interest in this asset class. Especially

Asian private equity markets have interest investors a lot.

Convertible bond weight we maintain at neutral. We have not made great changes in our convertible side allocation. The more moderate sensitivity to the underlying market, compared to equity markets, gives some protection against bearing company risk.

In hedge funds, we still maintain our overweight recommendation. A significant amount of funds globally are still flowing to hedge funds and last year, fund-of-funds activity gathered 4% of new to invest (before performance). Our fixed income hedge fund continues in its good performance. Last year, this fund yielded 12%.

Commodities

In commodity markets, especially agricultural raw material prices have

been under strong pressure in January and in the end, caused dramatic political restlessness in the MENA area. In Asia, food price inflation is accelerating and central banks are in a rush to tighten refinancing rates. Most recently, Indonesia raised its rate by 0.25% to 6.25% slightly surprisingly out of schedule. In many agricultural commodities derivative positions, the so-called speculative long positions are at their highest level in this cycle and we view the current pricing situation to be slightly challenging.

Currently we are tactical net short in corn and wheat in our Global Food basket. The pull of industrial metals continues strongly and copper is daily beating cycle peaks. We lower commodity allocation weight from pure overweight to moderate overweight.

Market outlook (change to previous month)		Monthly recommendations 6/2008 - 2/2011*																														
		6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12	1	2	3	4	5	6	7	8	9	10	11	12
Fixed Income: Moderate underweight	(=)	4	4	4	4	3	4	4	4	4	4	4	3	3	3	4	3	3	3	2	2	2	2	2	2	2	2	2	2	2	2	
Europe money markets: Underweight	(=)	5	5	5	5	5	5	5	4	3	2	2	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1		
Europe government bonds: Moderate underweight	(+)	2	2	3	4	4	3	3	1	1	2	2	1	2	2	3	2	2	2	1	1	2	2	1	1	1	1	1	1	1	2	
Investment Grade: Neutral	(=)	4	3	3	3	3	3	4	5	5	5	5	5	5	5	5	5	4	4	4	4	4	3	3	3	3	3	3	3	3		
High Yield and structured products: Neutral	(-)	4	4	4	3	3	3	3	3	3	3	3	4	3	3	3	2	3	3	3	4	4	4	4	4	4	4	4	4	4	3	
Emerging market bonds: Moderate overweight	(=)	4	5	5	4	4	4	4	4	4	3	3	3	2	2	2	2	3	3	3	4	4	4	4	4	4	4	4	4	4	4	
Inflation: Neutral	(=)	4	3	3	3	3	4	4	3	2	3	2	2	3	3	2	3	2	2	1	2	2	1	2	3	2	2	3	3	3	3	
Equities: Neutral	(=)	1	2	2	2	2	1	3	3	2	2	4	4	3	3	4	4	3	3	4	5	5	5	3	5	4	4	3	3	4	3	
USA: Moderate overweight	(=)	3	3	2	2	2	2	3	3	3	4	3	3	3	4	4	3	3	4	4	4	4	5	4	3	2	1	3	3	4	4	
Europe: Neutral	(+)	1	1	2	1	1	1	2	2	2	2	3	3	3	2	2	3	3	2	2	2	2	1	2	3	4	5	3	3	2	2	
Japan: Moderate underweight	(=)	2	2	2	2	2	1	2	2	1	1	1	1	1	2	2	2	1	1	1	1	2	2	2	2	2	2	2	1	2	2	
Emerging Market Equities: Neutral	(-)	3	3	2	2	2	3	3	4	4	3	4	4	5	5	4	4	4	3	4	4	5	5	5	5	5	5	5	5	5	4	3
Alternative Investments: Moderate overweight	(=)	3	3	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	3	3	3	3	3	3	3	3	3	3	4	4
Private Equity: Neutral	(=)	3	2	2	2	2	3	3	2	2	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	2	2	3	3
Real Estate: Neutral	(=)	1	1	1	1	1	1	2	2	2	1	1	1	3	3	3	4	4	4	4	4	3	3	3	3	3	3	3	3	3	3	3
Hedge Funds: Moderate overweight	(=)	5	5	5	5	5	3	3	3	3	3	3	4	4	4	4	3	4	3	4	4	4	5	5	4	4	4	4	4	4	4	4
Convertible Bonds: Neutral	(=)														4	4	4	3	2	2	2	3	3	3	2	3	3	2	2	3	3	
Commodities: Moderate overweight	(-)	3	3	3	1	1	3	4	4	4	4	4	4	3	2	3	3	4	3	3	4	3	3	4	4	4	4	4	5	5	5	4

* Explanations: 1 = Underweight, 2 = Moderate underweight, 3 = Neutral, 4 = Moderate overweight, 5 = Overweight