MANDATUM LIFE

Market Outlook

March 2011

Oil price on the rise – ECB prepares to raise rates

February was very two-fold in risky asset classes. The beginning of the month passed by in a trance-like state as economic data and the passed earnings season supported equity markets, but the acceleration of the situation in the Middle East and North America (MENA area) turned oil price to a dramatic rise while equities fell in western exchanges to month bottoms. The restlessness in Libya and other Arab countries as well as concerns regarding the spreading of protests to Saudi Arabia have clearly increased oil risk premium and also other raw material prices have been on the rise.

We have maintained our neutral equity weight recommendation and in places, we have kept an equity weight even lower than this in our portfolios. We will continue with the same theme in March. Macro data in itself in the G3 area has been encouraging, but investors have not charged to markets to buy stocks as they did at the beginning of the year. On the contrary, after the earnings season the escalating of the geopolitical situation has increased nervousness in equity markets.

We are also maintaining our allocation in fixed income markets at moderate underweight for fixed income and moderate overweight for alternative investments, especially commodities. Fixed income markets got a shock at the beginning of the month as the ECB signaled against market (and our) expectations that the first interest rate hike in this cycle could already be next month, i.e. at the meeting at the beginning of April.

The "strong vigilance" terminology in ECB jargon means the hike will happen at the next meeting. Central banks in Europe have been very concerned as inflation pressures have risen but the US's message has been towards a very light monetary policy. Yield spreads have begun to grow between Europe and the US in the short-end of the yield curve, which has strengthened the euro against the dollar. Longer government rates and swap rates rising continued at the beginning of February and at the end of the month, a slight glide of rates towards lower levels was seen until the ECB blew up shorter maturities clearly upwards. The 12-month euribor is now only slightly below 2% while in derivative markets, probability was increased that the rate hike from the prevailing 1% level would not be the only hike this year. Portuguese 5- and 10-year bond yield levels clearly rose over 7%, thus the time limit has most likely closed regarding market funding. We anticipate Portugal to seek an aid package from the euro area stabilization mechanism during the spring.

In equity markets, the sales pressures of EM exchanges did not really loosen not including a few exceptions. The rise in oil price supported especially Russian markets in February but otherwise the going was quite lame. In DM (developing market) stock exchanges the equities, which are extremely sensitive to EM growth (incl. Sweden) came clearly down as the correlation between oil price and stock exchanges quickly turned clearly negative.

We maintain our neutral equity weight in equity markets going into March.
After the well-went earnings season, especially momentum on changes in forecasts of earnings margins in Scandinavia has clearly curdled, while sales growth forecasts rise momentum is still positive. The rise in producer prices is beginning to show in Scandi markets and we anticipate similar development to mirror to the US and Europe. In Sweden, the strengthened currency is beginning to show in margins. In any case, allocation-wise equity markets seems to be quite attractive especially against fixed income markets in the long run statically inspected (without active investment management).

In commodity markets, focus is tightly on oil price. Brent and WTI qualities difference in dollar price have lost role as Brent-shorters were smoked out of their positions at latest when the situation in Libya escalated. The stability of Saudi Arabia is now in the focus of commodity markets and in the short-run. Oil price is not expected to go under decreasing pressures. On the contrary, even if OPEC would be getting ready to increase oil production to cover Libya's shutdowns, markets price the uncertainties to continue.

We maintain alternative investments in our allocation at moderate overweight and especially weigh energy commodities. Industrial metals (incl. copper) actually fell from peaks quite quickly with equity markets in the revisions of EM growth rates. Also a few agricultural commodities, strong sales have been seen during February (incl. corn and wheat).

Market Returns 28.2.2011

Fixed Income	Return 1m	Return 2011	Return 1y
JPM Money Mkt	0,10 %	0,20 %	1,14 %
JPM EMU Govt	-0,08 %	-0,46 %	-0,95 %
Barcleys Infl.Linked	0,60 %	0,96 %	2,53 %
JPM Credit Index	0,60 %	0,00 %	2,37 %
JPM High Yield	1,50 %	4,18 %	16,30 %
JPM GBI EM Divers. (LC)	0,74 %	-3,44 %	12,65 %
JPM EMBI+ (HC)	0,17 %	-0,32 %	9,74 %

Equity Markets	Return 1m	Return 2011	Return 1y
OMXH Mid Cap	1,12 %	2,99 %	23,64 %
Euro Stoxx 50	2,01 %	7,34 %	10,43 %
Stoxx 600	2,29 %	3,41 %	16,55 %
S&P 500	3,20 %	5,51 %	20,17 %
Dow Jones	2,81 %	5,68 %	18,41 %
Nasdaq	3,04 %	4,48 %	24,31 %
Nikkei	3,77 %	3,86 %	4,92 %
Hang Seng	-0,47 %	1,47 %	13,24 %
India	-2,75 %	-12,58 %	8,48 %
Russia (RTS)	5,33 %	11,28 %	41,69 %
Brazil	1,21 %	-2,77 %	1,32 %
MSCI Europe	2,32 %	3,51 %	16,16 %
MSCI World	3,11 %	4,54 %	19,21 %
MSCI Emerging Markets	-0,93 %	-3,15 %	20,91 %
MSCI Latin America	1,90 %	-2,37 %	14,94 %
MSCI Eastern Europe	4,87 %	9,49 %	28,59 %

Alternative Investments	Return 1m	Return 2011	Return 1y
S&P Commodity TR	3,75 %	8,63 %	19,89 %
Oil (spot)	2,85 %	6,13 %	16,93 %
Gold (spot)	5,65 %	0,13 %	25,18 %
HFRX Global HF	0,77 %	1,72 %	5,79 %

Foreign exchange	28.2.2011	31.1.2011
EURUSD	1,381	1,369
EURJPY	112,91	112,340
USDJPY	81,78	82,040
EURGBP	0,85	0,855
EURSEK	8,73	8,829
EURNOK	7,73	7,909
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	1,09	1,07
Euribor 12m	1,77	1,64
Germany10y	3,17	3,16
iTraxx Europe 5y (IG)	97,58	98,18
iTraxx Crossover 5y (HY)	386,31	415,75

MANDATUM LIFE

Fixed Income

Past events

ECB preparing for a rate hike

Against our expectations, the ECB threw itself on the path towards interest rate hikes clearly early than we expected. During the interest rate meet at the beginning of the year it became clear that inflation pressures drive the ECB to tighten its monetary policy already in April. Trichet signaled the interest rate hike nearly as explicitly as it can be done. Especially for the recovery of Southern European countries, the interest rate hike is a tough spot. In Spain, the unemployment rate and prevailing growth expectations would not require a hike in any case but for Germany, it may be in place. All in all, behind the hawkish message is the ECB's straightforward procedure for medium term price stability, which according to their analysis has shown clear unease.

Inflation speeds in Europe are aggregately rising, but core inflation (cleaned of food and energy prices) on the other hand has been tame. The spring's wage negotiations the interest rate hike theme will bring its own color, but all in all, the central bank in its own forecasts forecast inflation to calm down next year. Also in England, the last BoE's meeting minutes bode the interest rate hike schedule to be nearing. In the UK, inflation speed is around 4%. On the other hand, in Eastern Europe another situation is being played out. In Poland, the refinancing rate was left at 3.75% and the central bank's tone was even soft. High yield bond continued with their strong hold in February over-performing in both investment grade and subordinated markets. Low credit default rates continue to support high yield bond markets as the amount of new issues has remained at a low level.

Current situation

Game over for Portugal

Main focus of markets is now after the earnings season, on the MENA area crisis, with the situation in peripheral euro areas remaining in the sidelines. The situation especially in Portugal has turned alarming, as both 5-year and 10-year government bond yield levels spread to clearly over 7%. We do not view Portugal to make it out of its mess alone; instead we anticipate it to seek an aid package from the eurozone stabilization fund. The funds are sufficient in Europe, but for Spain and Italy, the situation is worse. European leaders are next meeting at the end of March and without the concrete increasing in size of the aid packages or the realization of loan guarantees, we view markets to be disappointed with results.

Commissioner Rehn has trumpeted bank senior loan holders to be safe, but in markets especially the premiums on Irish banks' senior bond premiums have been alarmingly high. Also alarming is the results of an analysis of Spanish banks abilities to fund themselves with market funding and funds offered by the ECB are still taken. Spain has continued determinedly to cut its budget deficit and to revitalize its banking sector. New stress tests for banks are around the corner and already the leaked parameters have left room for analysis that especially not all Spanish Cajas (savings banks) would pass the tests.

The future

Rise in oil prices supports some EM countries and hits others badly

Emerging fixed income markets have clearly had a theme in February; countries with surplussed trade balances are usually exporters of oil and raw materials, i.e. the strengthening pressures of the currencies have clearly supported investors who invested in local currency bonds. On the other hand, the high deficit countries have seen investors to pull funds from the countries, which are relying on imported raw materials. Turkey and India are good examples of the latter type.

All in all, we view EM areas as a whole to be much closer to the output gap (difference between actual and trend GDP growth) in a lock out situation, leaving space for inflation pressures. In this sense, we view many EM central banks to be a bit behind with their interest rate hikes and thus global, a unique situation is prevailing as since a long time, the Fed is not heading the interest rate hike cycle. On the contrary, we anticipate the Fed to raise its fed funds rate only in 2012, thus leaving room for the widening of spreads also against the DM areas. Trade weightedly against US trade partners the dollar has weakened over 3% this year, which in its part supports the revival of the US. In any case, the more hawkish ECB has caused 2-year swap rate spreads to widen from last May's zero-situation to the current 1.25% leaving possible room for the strengthening of the euro against the dollar.

MANDATUM LIFE

Equities

Past events

Rise in oil prices supports some EM countries and hits others badly

In equity markets, risk willingness weakened clearly as oil price rose to three digit figures as the situation in Libya escalated. The USD10 rise in oil price will decrease US GDP speed by -0.2% during the first year and raise global inflation speed by 0.2%. In EM countries, the already tight inflationary conditions weaken foreign investors short-term interest but in the long run the situation is different. EM has in any case continued to under-perform against the DM equity markets also in February.

In February, rotation between different sector in US equity markets continued and energy was a clear over-performer against the general index also in Europe. In Europe, the lift of small companies has continued more positively against the general index.

Equity market volatility rose naturally due to sales pressure at the end of February, but still the prevailing volatility levels (VIX 20 and VDAX 18) are quite low. Noteworthy is that many other asset classes' price volatility more aggressively against the prevailing situation in equity markets (fixed income market, currency market and commodity markets).

Current situation

How are earnings margings doing?

Companies' pressures on earnings margins, due to the risen raw material prices, are one of the main questions for investors. We have inspected the change momentum of Nordic stock exchange companies on a 3-month rolling time horizon and currently, the prevailing tendency is that the rise momentum of margins has faded while at the same time the forecasting momentum of sales is rising. The level of final demand and the pricing power of individual companies dictate a lot of course, but on an index-level the effects are multiplied. In the US, especially from small sized companies have reported that the rising raw material prices have not been able to been transferred to final products.

The main EM market exchanges development in Asia has been significantly sensitive to China's monetary and fiscal policies. China's purchasing manager's index is currently fading from its best rise (52.2) and the monetary supply growth has been confined significantly been though on a M3 level, growth speed is still around 15% in China. We generally anticipate the underperforming of EM exchanges to continue for a awhile, but especially raw material sensitive exchanges, such as Russia, are our favorites now. We maintain our neutral stance in equities and keep US equities at moderate overweight. The P/E of our active America Equity basket is now below 10.

European banking sector equities track has slowly recovered against the general index, but the clearly more hawkish tone of the ECB calmed the going of Southern European banks. Dividend yield levels are in any case being upped, as HSBC reported lowering its ROE target by a fifth, quoting regulatory pressures.

The future

Geopolitics in drivers seat

After the earnings season, main market focus is again on macro economic data and now more and more on the situation in the Middle East and Northern Africa. The basic situation in macro data is positive, but a few concerning tones has been heard from the emerging markets. In China, the austerity measures are working and the PMI has turned to a calm track.

Companies quoted pressures on prices, especially producer prices when reporting earnings, but especially in the US employment costs have remained in tack and after the drastic cost cutting programs, company management are reassuring that they will improve margins this year. Especially in the consumer sector (incl. McDonald's), increased raw material prices have bothered margin development estimates and the sector has been an underperformer this year against the general index.

In Scandinavia, companies sensitive to EM growth have been under sales pressures since the beginning of the year and for a reason so. But, in places 20% drops in stock prices have turned the picture more positive. Nevertheless, margin pressures are visible and we do not believe that in the short-term momentum will change even with a consensus during the prevailing time of rises in raw material prices. Profit warnings will most probably be more abundant this spring compared to the last.

Alternative investments

Real Estate

Regarding real estate, we are not making significant changes. Our neutral allocation weight is maintained. Real estate activity has increased from last year's levels also in Finland. The low interest rate levels have supported the pricing development in Europe and now interest is focused on how sensitively retail demand reacts to ECB's message of a tightening monetary policy.

Alternative Investments

We keep our private equity allocation weight at neutral. The progressing of IPO markets and the overall actualization of private equity delays will further raise interest in this asset class. At least one big IPO is expected in the Nordics for the spring.

We maintain convertible bond weight at neutral. We have not made changes to our convertible bond allocation. The lower sensitivity to the underlying market protects from company risk.

In hedge funds, we maintain our moderate overweight recommendation. A relatively large amount of funds is flowing to hedge funds globally. Analyzing long/short hedge funds track at the beginning of the year, must be noted that their correlation with equity markets has slightly decreased indicating that the overpurchased situation has turned.

Commodities

In commodity market, we maintain our moderate overweight recommendation. We have closed our tactical net short positions in agricultural commodities with success in our Global Food basket mainly in wheat and corn. The rise in food prices is beginning to be a global theme also within the media. Copper price revised its worst over-buy in February, but especially in China the demand conditions appear strong according to producers (7% rise in demand growth this year).

Market outlook (change to previous month)		Monthly recommendations 6/2008 - 3/2011*																																	
		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	1	2	3
Fixed Income: Moderate underweight	**(=)**	4	4	4	4	3	4	4	4	4	4	4	3	3	3	4	3	3	3	3	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Europe money markets: Underweight	(=)	5	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	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	2	1	1	2	2	2	1	1	1	1	1	1	1	1	2	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	4	4	3	3	3	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	4	4	4	3	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	3	4	4	4	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	2	3	3	3	3	3	3	3
Equities: Neutral	**(=)**	1	2	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	4	3	3	4	3	3	3
USA: Moderate overweight	(=)	3	3	2	2	2	2	2	3	3	3	4	3	3	3	4	4	3	3	4	4	4	4	4	5	4	3	2	1	3	3	4	4	4	4
Europe: Neutral	(=)	1	1	2	1	1	1	1	2	2	2	2	3	3	3	2	2	3	3	2	2	2	2	2	1	2	3	4	5	3	3	2	2	3	3
Japan: Moderate underweight	(=)	2	2	2	2	2	2	1	2	2	1	1	1	1	1	2	2	2	1	1	1	1	1	2	2	2	2	2	2	2	1	2	2	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	4	5	5	5	5	5	5	5	5	5	4	3	3
Alternvative Investments: Moderate overweight	**(=)**	3	3	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	3	3	3	4	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	1	2	2	3	3	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	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	4	5	5	4	4	4	4	4	4	4	4	4	4
Convertible Bonds: Neutral	(=)													4	4	4	3	2	2	2	3	3	3	3	2	3	3	3	2	2	3	3	3	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	5	5	4	4

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