MANDATUM LIFE

Market Outlook

February 2012

The willingness to take risk made a strong comeback

The new year had a jaunty start as risky asset classes showed strong figures. According to our previous anticipations the equity markets witnessed a wide sector rotation when the weakest sectors last year were in great shape at the beginning of the year. Those who invest against benchmark indices have adjusted their portfolios in accordance with index weights early 2012. It appears that ECB´s liquidity impulse still supports risky asset classes. As the macro picture is improving and inflation development is moderating at the same time, the standings for rises in stock exchanges have been positive.

Allocation Weights

-Fixed Income: We maintain a neutral allocation weight in fixed income.

-Equities: We hold our neutral recommendation for equities also in February, even though the majority of the investment flow aiming at index weights has probably been seen already.

-Alternative Investments: We stand at a neutral weight in alternative investments.

Funding is again functioning on the markets spurred by ECB actions

On the interest markets, our recommendation of overweighting corporate bonds has proved successful at the beginning of the year. Also high yield rated corporate bonds have performed strongly early 2012. New issue markets have taken off and the bank´s funding channel starts to function again. Banks in the Euro area have managed to issue equity funding after a long break. ECB´s LTRO (long term refinancing operation) has secured funding for problem banks for as long as three years with 1% interest. Also other banks have taken advantage of this funding and investing possibility. Italian and Spanish 10-year government bond interest rates have fallen under 6%. Thus, pricing the tail risks in the probability distribution is exiting the market for now.

Earnings season brings uncertainty to the market after the January´s rally

Greediness took a sharp defeat over fear at the beginning of the year. Even at the global scale stock exchanges showed similar signals when last year´s losers now shined as rising stars, and the other way around. At the year start the defensive sectors have struggled, whereas amongst others small companies have clearly over performed the general indices. We are targeting neutral weights in our combined and mandate portfolios in February. The earnings season for the last quarter of 2011 is here and there is not expected to become as many positive surprises as during other three quarters in 2011. Our guidance for this year is still somewhat gloomy as it also was in 2011. We anticipate that profit margins generally fall this year from last year´s levels.

Volatility calmed down and the risk index fell in early 2012

The volatility (price swings) has fallen remarkably in early 2012. Also our Mandatum Life risk index has dropped drastically from the top figures seen late 2011 which describes how the tension is cooling down in all asset classes. In our recommendation, we level the weight of convertible bonds up to moderate overweight. Hedge funds are as well lifted to moderate overweight. On the currency markets, euro´s correlation with risk taking willingness has dropped. Thus, it seems that the markets are taking further consideration into ECB interest steering actions and hereby into euro´s fundaments.

Juhani Lehtonen, director
Investment Management

Markets Returns 31.1.2012

Fixed Income	Return 1m	Return 2012	Return 1y
JPM Money Mkt	0,22 %	0,22 %	1,81 %
JPM EMU Govt	1,49 %	1,49 %	3,70 %
Barcleys Infl.Linked	2,34 %	2,34 %	1,02 %
JPM Credit Index	1,89 %	1,89 %	6,26 %
JPM High Yield	5,23 %	5,23 %	4,28 %
JPM GBI EM Divers. (LC)	6,52 %	6,52 %	12,26 %
JPM EMBI+ (HC)	1,47 %	1,47 %	11,47 %

Equity Markets	Return 1m	Return 2012	Return 1y
OMXH Mid Cap	8,08 %	8,08 %	-23,56 %
Euro Stoxx 50	4,32 %	4,32 %	-18,18 %
Stoxx 600	4,04 %	4,04 %	-9,16 %
S&P 500	4,36 %	4,36 %	2,04 %
Dow Jones	3,40 %	3,40 %	6,23 %
Nasdaq	8,01 %	8,01 %	4,21 %
Nikkei	4,11 %	4,11 %	-14,02 %
Hang Seng	10,61 %	10,61 %	-13,04 %
India	11,25 %	11,25 %	-6,19 %
Russia (RTS)	14,14 %	14,14 %	-15,67 %
Brazil	11,13 %	11,13 %	-5,26 %
MSCI Europe	3,68 %	3,68 %	-9,12 %
MSCI World	5,48 %	5,48 %	-5,98 %
MSCI Emerging Markets	11,34 %	11,34 %	-6,64 %
MSCI Latin America	12,47 %	12,47 %	-7,98 %
MSCI Eastern Europe	14,65 %	14,65 %	-15,50 %

Alternative Investments	Return 1m	Return 2012	Return 1y
S&P Commodity TR	2,23 %	2,23 %	-1,96 %
Oil (spot)	-0,53 %	-0,53 %	-1,30 %
Gold (spot)	10,90 %	10,90 %	29,37 %
HFRX Global HF	1,66 %	1,66 %	-7,67 %

Foreign exchange	31.1.2012	30.12.2011
EURUSD	1,308	1,296
EURJPY	99,78	99,66
USDJPY	76,27	76,91
EURGBP	0,83	0,83
EURSEK	8,90	8,92
EURNOK	7,67	7,74
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	1,13	1,36
Euribor 12m	1,75	1,95
Germany10y	1,79	1,83
iTraxx Europe 5y (IG)	143,49	173,00
iTraxx Crossover 5y (HY)	619,65	754,80

Source: Bloomberg

MANDATUM LIFE

Fixed Income

Past events

ECB's actions seem to work

The European Central Bank's action to supply markets with liquidity (LTRO) has after initial thoughts begun to work. The functionality of financial channels for banks are returning and credit risk premiums have clearly narrowed in different maturities. In other words, it looks as if the markets are satisfied with the amount of money that the ECB has used for resuscitation. Southern European Government bond yields have declined and the first auctions of the year have gone quite well. Nevertheless, the situation in Greece is still wide open as the Troika continues to arm wrestle with the private sector regarding the percentage of write-downs. In addition to this, the fate of ECB owned Greek government bonds, following the nominal write-downs in the private sector, is still unsure. Meanwhile in the markets, Portuguese government bond yields have risen substantially in the beginning of this year, which indicates that markets are beginning to believe that Portugal will have to carry out a similar operation as Greece. According to the terms of Portugal's original bailout package, the country would reenter long-term debt markets in 2013, but this schedule looks very challenging. ECB's next long LTRO operation will commence at the end of February , and it will be interesting to see how much financing will be sought after from the central bank. A few European banks that are in rather good shape have indicated that they will not use ECB's extra liquidity due to reputational risk issues and in order to eliminate any additional stress in the markets. It may well be that the operation at the end of February will be the ECB's largest liquidity injection in history, which would also mean a great increase in the size of the ECB's balance sheet.

Current situation

Corporate bond markets active right from the beginning of the year

The new issue market opened quickly right from the beginning of the year. Companies set out to secure their financing and the banking sector succeeded in borrowing from money markets after last years deep freeze. The demand for new corporate issues has been very strong, and bonds have been oversubscribed multiple times. This partly illustrates the risk taking willingness of investors as well the amount of cash in portfolios. Following the situation at the end of last year and despite the strong volatility, tempting yield levels are attracting investors more. The strength of demand is supported by the fact that in Europe, high yield companies in a frail state have been able to borrow money from markets through clearly oversubscribed new issues.

We expect the issuing of new corporate bonds to remain strong in February as well, but in our opinion, selectivity will once again play a key role when making investment decisions.

Within our Fixed income basket, we have from the beginning of this year purchased British pound denominated Norwegian DnB NOR and Norwegian kroner denominated Seadrill. Credit failures are at a low level and central credit rating agencies anticipate there to be only a small rise should Europe fall into a deeper recession. The cash positions of companies in Europe and the U.S. are generally at moderately strong levels. The credit rating cuts of nine Euro zone countries by S&P led to credit rating cuts in the banking sector as well.

The future

Central banks remain proactive

Economic growth indicators are leveling off in Europe and the U.S., and the sharpest falls in confidence indices are beginning to end. Nevertheless, Southern European countries are still drowning in recession figures (PMI's 42-49) and unemployment figures are on the rise, but in central western economies the tide is turning. Markets have still lowered forecasts, as the consensus forecasts a –0.5% drop in the Euro zone GDP for this year, where as three months ago we were at +0.7% For the U.S., the consensus estimates a rise of 2.3% in GDP growth, so the gap is spreading between the Atlantic. When looking at different measurement tools that indicate how economic data has exceeded forecasts, we can see that in Europe surprises in economic data actually accumulate into the positive (albeit from low levels). On the other hand, in the U.S., the days of surprisingly positive economic data are behind us. Still the central banks have indicated in favor of resuscitative monetary policies and in the U.S. the FED has changed its ways and will inform more specifically the interest rate projections of the open market committee. To summarize, FED will keep liquidity high and interest rates low for long, and in Europe the ECB is heading in the same direction.

Central banks in emerging markets have also been able to practice more resuscitative monetary policies as inflation is settling down in growing markets. China's central bank has been able to lower the reserves ratio of bank held funds due to slowing inflation (now 4.8%) and we have seen the first key interest rate cuts in Brazil. Also policies in India and Russia have eased. We are slightly increasing the interest weight in Emerging markets within our interest allocation recommendations. To sum up, the profile of riskier asset classes is supported by the position of central banks which will remain resuscitative in February as well.

Equities

Past events

January was historically strong

The equity markets scraped out purchasing lists quickly after an initial astonishment and the way forward followed this sentiment. In a sector inspection is revealed an intense rotation back to index weights by such investors, who follow a reference index in their activities. In the Eurostoxx 600 –index, the bank (+9,5 %), insurance- (+10,6 %) and car industries (+20,9 %) were at the top of the list of rising sectors, when again the last years winning sectors health care (-1,4 %), telecommunication (-2,6 %) and retail sales (-3,8 %) were losers of the sector rotation in January. In the US the list is almost identical. On the whole when the investment flow is analyzed, it can be seen, that on a net level the US equity funds did hardly get any more funds (AMG-data), and the performance in Europe supports the same analysis. Of the most central markets Russia rose +14 % in January whereas Brazil rose +11 %. In Kina the Hong Kong stock exchange rose +10,6 % in January once the investors returned to the markets after the start of the revival policy by the central government. We cut our equity weights slightly at the middle of January, but the cyclical underlying equity investments (especially Metso and Konecranes) of our mixed funds and mandates have managed clearly better than market indices.

Current situation

Main focus is on the reporting period

The reporting period from the last quarter 2011 has had a slightly volatile beginning. Generally speaking the US results have not surprised as positively as was the case concerning last years other quarters. We are still in a situation, where firms' result forecasts (studied by the number of pieces) have more been reduced than raised for this year's part, but in net terms the result forecast cuts are relatively moderate. The markets anticipate that the S&P 500 -firms will report a growth of +4 % in sales for this year from the reported levels of 2011. This year's result forecasts (S&P 500) have on their part been reduced from the end position of October by ca -4,5 %. In Europe the situation is nearly identical. It will be interesting to see, that a few month decrease in result forecasts simultaneously with the witnessed climb in stock exchange rates surely sends the analysts to once again raise their own forecasts for growth and at the same time raise their target prices for equities. We anticipate that result margins will end up being presurized this year, and especially in the US the strengthened dollar from last years levels, will inevitably hinder the relative over performance against euro firms. In the already reported results it is the result margins that have been the places for disappointment, when raw material prices have remained on fairly high levels and firms have on average not been able to transfer the escalated raw material prices to end products.

The future

Risk willingness seems to suffice

It can largely be seen from the reporting period, that firms are very reluctant to give clear instructions on the growth of their results or sales. Especially in the US, the result steerings from firms are clearly weaker than after last year's third quarter. Small business stock prices have continued to over perform the general index in the US and recent employment data and the small business sentiment inquiries support the development. All in all, the small and micro firms' good relative development against the index also tells of the willingness to take risk at the moment. We have added cyclical weight to our portfolios and will continue in the same way also in February. At the end of January we bought Transocean equities and Hoegn LNG equities from an emission to our mandates. The Mail.ru –firms weight is fairly high in our Russia-basket and the potential equity emission of Facebook is interesting, since Mail.ru owns 3,1 % of Facebook. Some Finnish equities are already close to our target prices, so we will take the ascent of these to our books, as long as the time is right. The resuscitation by central banks, the lower inflation development also in the growth markets, the decrease in interest rate levels of the euro area's great problem countries, the macro data that is on a constructive level and the improved investor sentiment all support a share price increase in February. We will continue to pursue a neutral equity market weight in our allocation also in February, even though we are aware, that especially the momentum favors an already clearly over purchased situation in the short run for many central equity indices.

Alternative Investments

Alternative investments

Private equity is held at underweight in our allocation. Convertible bonds are instead levelled up to moderate overweight. The convertible bond markets have gained as the underlying equity markets have risen. To some extent convertible bond prices have climbed remarkably as the credit risk premiums have tautened at the same time.

Our allocation recommendation for hedge funds is also lifted to moderate overweight. Hedge funds have reverted well after the tortuous 2011 at the year start and the general willingness to risk taking supports hedge funds. Our hedge fund on the interest side opened the year strongly by rising +1.5%. The hedge fund investing in Asian stocks also performed strongly as it climbed by +5.3% in January.

Commodities

On the commodity markets, attention has been paid on the oil price which has somewhat given up the 100 USD level seen at the turn of the year. The standings in the Middle East are, however, anything but calm. The price of natural gas has been decreasing rapidly in USA after late 2011 and we are actively monitoring the process. Industrial metals have experienced a considerable bounce and our investments on the sector rose over +10% in January. We do not hold any significant positions in agricultural commodities at the moment. As a whole, we maintain a neutral allocation recommendation for commodities.

Market outlook (change to previous month)		Monthly recommendations 9/2009 - 1/2012*																													
		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
Fixed Income: Neutral	**(=)**	3	3	3	3	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	3	3	3	3	3	3
Europe money markets: Moderate underweight	(=)	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1	2	2	2	2	2	2
Europe government bonds: Underweight	(=)	2	2	2	2	1	1	2	2	2	1	1	1	1	1	1	1	1	2	2	1	1	1	1	1	1	1	1	1	1	1
Investment grade: Overweight	(=)	5	4	4	4	4	4	4	4	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	4	5	5	5	5	5
High yield and structured products: Moderate overweight	(=)	2	3	3	3	4	4	4	4	4	4	4	4	4	4	4	4	4	3	3	2	2	2	2	2	3	4	4	4	4	4
Emerging market bonds: Neutral	(+)	2	3	3	3	3	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	4	3	2	2	2	2	3
Inflation: Moderate underweight	(-)	3	2	2	1	2	2	1	2	3	2	2	2	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	2
Equities: Neutral	**(=)**	4	4	3	3	4	5	5	5	3	5	4	4	4	3	3	4	3	3	3	3	3	3	4	3	2	2	2	3	3	3
USA: Moderate underweight	(=)	4	3	3	4	4	4	4	4	5	4	3	2	1	3	3	4	4	4	4	4	4	3	3	3	3	1	2	2	2	2
Europe: Moderate overweight	(=)	2	3	3	2	2	2	2	2	1	2	3	4	5	3	3	2	2	3	3	3	2	3	3	3	3	5	4	4	4	4
Japan: Moderate underweight	(=)	2	2	1	1	1	1	1	2	2	2	2	2	2	2	1	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Emerging markets: Neutral	(=)	4	4	3	4	4	5	4	5	5	5	5	5	5	5	5	5	4	3	3	3	4	4	4	4	4	3	3	3	3	3
Alternative Investments: Neutral	**(=)**	2	2	2	3	3	3	3	3	3	3	3	3	3	3	3	3	4	4	4	4	4	4	3	3	3	3	3	3	3	3
Private equity: Underweight	(=)	1	1	1	1	1	1	1	1	1	1	1	1	1	2	2	3	3	3	3	3	3	2	1	1	1	1	1	1	1	1
Real estate: Neutral	(=)	4	4	4	4	4	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3
Hedge funds: Moderate overweight	(+)	3	4	3	4	4	4	4	5	5	4	4	4	4	4	4	4	4	4	4	3	3	3	3	3	3	3	3	3	3	4
Convertible bonds: Moderate overweight	(+)	3	2	2	2	3	3	3	3	2	3	3	3	2	2	3	3	3	3	3	4	4	4	3	3	3	2	3	3	3	4
Commodities: Neutral	(=)	3	4	3	3	4	3	3	4	4	4	4	4	5	5	5	5	5	4	4	3	3	3	4	3	3	2	2	3	3	3

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