MANDATUM LIFE

Market Outlook

July 2010

The partly ceasing stimulus keeps investors on their toes as growth falters

Risky asset classes revised well in the beginning of June after robust sales in May. Nevertheless, mid-month investors concerns over government stimuli partly ceasing, gnawed market sentiment and stock markets retreated significantly at the end of the month. We lower equity weight from pure overweight to moderate overweight. We do not expect corporate Q2 results to disappoint expectations badly, but we do expect outlook communications to markets to be weak, so that analysts and investors will not, on average, be ready to raise earning outlooks significantly for the year-end and next year. This results in macro figures and sentiment driving stock markets over the summer and thus, due to increased volatility, we slightly lower equity weight. Global economic growth is clearly faltering as we enter the second half of the year, and combined with concerns over government indebtedness accelerating, these factors have driven investors to clearly diminish risky asset class weight. Regarding fixed income and alternative investments, we are not making changes to our allocation.

As a result of risk aversion, interest rate levels of riskless government bonds have fallen worldwide. The US 10-year treasury yield is below 3% and longer German government bond yields have fallen dramatically, even partly below Lehman-times levels (10-year 2.55% and 30-year 3.25%). Also Japan's 10-year government yield has fallen near 1%. Globally, large balance sheet investors (incl. pension and life insurance investors) have a strong inclination to hedge their interest rate risk positions as risky asset classes' retreat, partly causing government bonds and interest rate swap yield levels to fall. In addition, the current moderation of the inflation environment and the expectations of future inflation have kept interest rate risk buyers on the move. ECB's, to this day, longest year-long market operation (450 billion EUR)that maturing at the end of June and the focusing of the central bank on offering shorter (3month) liquidity operations to markets, has slighted raised Euribor rates. Money markets lost around 200 billion euros of liquidity. We anticipate short Euribor rates to rise moderately during the autumn, towards ECB's refinancing rate level of 1%. All in all, Spain's and other Southern European countries government and bank access to markets (government bond issues, market funding availability and price) is still a central concern in funding markets in the euro area. Our money market weight remains at underweight, as does our government bond weight. Corporate bonds we are retain at neutral and high yield bonds at overweight with EMD markets.

Macro figures have clearly shown incongruity, as purchasing managers' confidence figures have bended downwards from very robust levels. Especially new orders and inventory portraying sub-indices retracting, foretell of a small moderation in real economy demand levels as companies prepare for a post-stimulus time. As the ECB removes excess liquidity and at the same time, the tax credit program, which cheered US housing market data, expiring has driven market parties to clearly weigh year-end demand levels. We anticipate actual earnings growth to stay at a good level (12 months forwards-looking earnings growth speed +27% in the US) but signaling and earning management are still weak in companies. We lower US allocation weight within equities to neutral from moderate overweight and respectively raise European weight to neutral from moderate underweight. We are thus realizing profits from this relative recommendation. Trade partner weighedly, the euro exchange rate has drastically weakened during Q2, which is visible in export figures and export company order books in the euro area. Relatively examined, euro area industrial companies have over-performed their US peers in May-June and we anticipate this development to continue. A larger question is how the tightening of monetary and fiscal policy in China caused demand and confidence indicators to retract, has left the large euro area export market demand level unclear. This year, we anticipate Chinese economic growth to be around 10%, according to the trend growth speed.

In alternative investments, we are not making changes for July. The neutral positioning in our allocation remains. In raw materials, the basic situation has not changed. Chinese demand figures drive industrial metal sentiment, and agricultural commodities continue with their incongruity. Though, the most recent USDA figures of cultivation development turned corn's slide-trend around for the time being. In hedge funds, a general feature is that long/short equity managers have been moving forth with a quite careful position. Generally, the same applies for hedge funds investing in currency markets.

Market Returns 30.6.2010

Fixed Income	Return 1m	Return 2010	Return 1y
JPM Money Mkt	0,09 %	0,51 %	1,26 %
JPM EMU Govt	-0,92 %	2,24 %	5,17 %
Barcleys Infl.Linked	-1,05 %	1,33 %	5,44 %
JPM Credit Index	0,46 %	3,86 %	9,73 %
JPM High Yield	1,07 %	5,57 %	33,00 %
JPM GBI EM Divers. (LC)	2,01 %	21,72 %	32,69 %
JPM EMBI+ (HC)	1,88 %	5,08 %	17,27 %

Equity Markets	Return 1m	Return 2010	Return 1y
OMXH Mid Cap	0,19 %	1,77 %	29,33 %
Euro Stoxx 50	-2,21 %	-13,82 %	6,44 %
Stoxx 600	-0,08 %	-3,69 %	18,46 %
S&P 500	-4,42 %	-7,56 %	13,26 %
Dow Jones	-2,63 %	-6,43 %	16,85 %
Nasdaq	-5,40 %	-6,81 %	16,36 %
Nikkei	-1,97 %	-9,25 %	-3,89 %
Hang Seng	2,44 %	-5,80 %	10,18 %
India	3,98 %	1,10 %	20,98 %
Russia (RTS)	-0,79 %	-4,97 %	37,39 %
Brazil	0,05 %	-9,64 %	20,43 %
MSCI Europe	-0,14 %	-3,91 %	17,83 %
MSCI World	-3,48 %	-10,36 %	10,09 %
MSCI Emerging Markets	1,00 %	-4,66 %	24,01 %
MSCI Latin America	0,38 %	-10,19 %	24,19 %
MSCI Eastern Europe	-4,35 %	-12,47 %	21,34 %

Alternative Investments	Return 1m	Return 2010	Return 1y
S&P Commodity TR	0,11 %	-11,55 %	-5,72 %
Oil (spot)	1,04 %	-8,22 %	0,69 %
Gold (spot)	2,26 %	13,34 %	32,74 %
HFRX Global HF	-0,83 %	-1,14 %	5,81 %

Foreign exchange	29.6.10	28.5.10
EURUSD	1,219	1,227
EURJPY	107,98	111,770
USDJPY	88,60	91,060
EURGBP	0,81	0,849
EURSEK	9,51	9,633
EURNOK	7,94	7,962
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	0,76	0,70
Euribor 12m	1,31	1,26
Germany10y	2,56	2,68
iTraxx Europe 5 v (IG)	133,04	117,88
iTraxx Crossover 5 v (HY)	584,52	556,45

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Fixed Income

Past events

Spanish banks: trouble finding market funding

In European fixed income markets market, interest has focused on Southern European government debt-rolling in markets. Government bond auction demand and results are playing a significant role after many years in general risk willingness and especially in June, Spain's situation was in the loop. Smaller Spanish savings bank (cajas) mergers, as well as smaller banks overall access to market funding, kept investors on their toes as liquidity concerns accelerated. BBVA and Santander were able to fund themselves in markets, but ECB limits were used frequently. All in all, highly indebted countries abilities to take care of their debt burdens is culminated exactly in their access to markets, and in their credible and transparent communication of different conditions to markets. In itself, letting government debt /GDP go over 100% is problematic for debt-rolling, especially if GDP is already on a declining trend, as often is in these situations. In June, "ClubMed government" bond spread differences rose lead by Spain, especially in derivative markets (CDS) clearly near their all time peaks again after the spring. In June, 20% of these countries bank debt had to be rolled forward.

German government yield levels continued in their descent in longer maturities, but short-term bonds (2-years 0.67%) have stalled in place for some time now. After the drying up of liquidity in ECB's banking system, also money market rates in derivative markets have been under pressure to rise.

In corporate bonds, June brought a bunch of new issues in banking, finance and industrial companies. We were actively involved in Scandinavian issues, mostly in industrial firms. The additional premium often present in secondary markets was present strongly in issues. Of new Finnish corporate bonds, especially the NesteOil 2015-bond was 4-5 times oversubscribed.

Current situation

Threat of deflation still on

After the dramatic fall in interest rate levels, investors are facing a new situation in Europe. The prevailing interest rate levels in German government bonds does not fulfill investor return demands in any way; on the contrary, the current pricing depicts the drastic fear of disinflatory development accelerating, and finally the preparation for deflation. The shift of interest rate hike expectations into the future has made longer maturity bond yield levels decline at the same time as risky asset class values have melted away in investors' portfolios. We do not expect the ECB to raise the refinancing rate during the current year, nor do we expect Fed to do so. Up until now, the ECB has bought around 55 billion-euros worth of government bonds from markets; mainly Greek, Portuguese and Irish bonds. The amount corresponds to around 10% of these countries outstanding loans, thus it is not a trivial operation. In the long run, the prevailing situation, in which the central bank is the only significant player in the market to offer liquidity to government bond markets, is not tenable. The ECB has communicated that it is going to sterilize the effect of the purchases - that is remove the same euro amount of liquidity from markets. At the end of June, the ECB could not in full achieve this.

Corporate and high yield bonds have performed, relatively examined, amazingly well compared to other risky asset classes. This can partly be explained with moderate secondary market trading. In any case, it is noteworthy that selectively examined, it looks like investors' value defensive corporate bonds and high yield return profiles even tough credit risk premiums have come dramatically down from last years' levels. Forecasts of actual credit defaults have not been made during the spring. Investor view strong balance sheet-bearing companies as clearly safer than even some governments, despite their tax collection right. Considering equities, it seems like the calmer economic growth state is enough for the corporate bond market currently trading on credit differences, while equity markets do seem to need growth momentum accelerating in the short term, which is not to be seen currently.

The future

Interest rates at low levels

In corporate bond markets, investment flow analysis shows investors adding investment grade weight to their portfolios. New emissions interest, despite the underlying low interest rate levels. We continue to see potential in corporate bonds, and we keep our allocation weight at neutral. Regarding high yield bonds, we maintain our selective approach. A more positive communication from credit raters to forest-companies has supported secondary market yield levels. We continue to seek possibilities in GBP and USD markets in these bonds. In focal currencies, the situation is identical for investors – cash does not yield anything, and yield has to be sought from corporate bond risk premiums.

In sovereign bond markets, a strong escape to quality continues. German government bond yield levels have fallen record-low, and we have shed interest rate sensitivity dramatically. We anticipate yield levels to have room to tactically rise, and thus we are not adding duration at these levels to our baskets. We anticipate Southern European country debt-rolling to continue to be a market concern, as even a small crack in demand will drive these countries' CDS-levels immediately wider, and increase turbulence in other risky asset classes.

In emerging market bonds, the situation continues to be positive yield-wise. Many EMD currencies have been driven to weaker levels in May-June and this opens possibilities for local currency denominated EMD markets. We have, for the time being, remained in the European EMD market in the Polish government 5 year sector.

Equities

Past events

Worries of economic growth weakening push stocks down after a rise in risk premiums

Economic growth seems to have turned, measured on many different indicators in the G3 –area, from peak levels, and because of this especially equity markets are very vulnerable. In light of confidence figures, new orders and inventory depicting indicators foretell a slightly calmer time in the short run after a boom. Significant differences do exist between continents. Due to the weakened euro, we view European export companies' outlooks to be clearly more attractive than those of their US peers. Industrial companies' stock prices in the euro area have now over-performed their US counterparts and general indices in Europe. Overall, also Scandinavian stock exchanges have done nicely in June, better than European indices.

Market volatility remained at a high level in June (expected and realized) as investors sought cover in derivative markets. The technical picture continues to appear fragile as many markets trade below their 200 -day rolling averages, which markets follow usually as a longer term trend indicator. Markets acknowledge the situation and redemptions have been seen in equity funds globally. BoA/Merril Lynch statistics show also US institutional investors cutting equity weights in June. Only 24% reported overweighing stocks compared to their benchmark indices (prev. May 30% and April 52%).

Banking stocks have been stuck as markets await stress test results and the overall forthcoming monitoring framework shape. In Europe, bank stress test results are beginning to trickle out at the end of July. The G-20 meet in Toronto did not reach a consensus regarding the global banking tax and regarding other monitoring, the direction seems to be in a more loose direction against worst market fears were.

The energy sector is both in the US and Europe clearly underperformed in June. BP's stock is at a large weight in these sub-indices. The Mexico Gulf situation is a certain kind of divider at this moment. The oil sector holds significant uncertainty in the short-run, but in a longer run we anticipate these events to only strengthen oil price development.

Current situation

Only a few earnings guidance revisions

Earnings guidance revision season is ongoing before the Q2 results season begins, and the message is carefully positive. The ratio between positive and negative earning revisions supports the development piloted in Q1, thus expectations are of a tolerably well passed earnings period. We anticipate earnings growth speed to stay in the current tracks, but guidance will be lurid which will keep stock volatility high over the earnings period. Analysts will not be able to yet raise earnings forecasts on a wide basis, which has traditionally signified a rise in stock price in markets.

We furthermore raise European weight against US to neutral. Overall we overweight, within Europe, companies with strong export markets in EM countries and hold strong balance sheets. Also Finland's (in spite of Nokia) and Scandinavian stock exchange development has been significantly better than in Europe on average. We are also realizing our cyclical overweight from Finnish and other Nordic exchanges.

We maintain our emerging market overweight recommendation. These markets are still relatively sensitive to international investment flows, due to weaker liquidity, and thus hold a negative momentum multiplicative effect if risk taking continues to be shunned. In any case, we view EM country stock exchanges to have value compared to many western stock exchanges due to strong domestic demand. Valuation levels in these countries, generally examined, are not disturbingly expensive (Hang Seng forward-looking 12 m P/E 13.0 and P/B 1.5 as well as dividend yield 3%).

The future

Q2 results important

Stock market interest is beginning to turn to the Q2 result publications in July. We view guidance to be the possible surprise momentum that will turn market sentiment; though we do not believe that on a general level companies dare bet on the year-end or on 2011. Our eye is especially on European export company order books. Clearly the weaker euro's effect is visible in stock prices and now is time for the order books. US GDP forecasts for the second quarter have been hurriedly raved downwards. The dollar's last few days weakening portrays this in part, so quick corrections in the euro exchange rate are not excluded, as positioning has clearly tilted towards euro shorts. We do still not currently believe that the export sector in the euro area would revise its relative over-performance; more likely is that exchange rates would revise massively. After the middle of July, we will receive more facts in the form of Q2 results, but as stated, we do no believe in significant surprises in actual earnings.

Valuation levels are still at tempting levels in stock markets. EuroStoxx50 index forward looking P/E is 9.2 and P/B 1.1. S&P500 index respective multiples are 11.8 and 1.8. We are again at the lower limits of recent valuation levels. Forward looking dividend yield level forecasts consensus-wise are also at quite interesting levels compared to riskless interest rate levels. EuroStoxx50 companies are at 4.95% levels and in the UK FTSE index at 4.01%.

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Alternative investments

Real Estate

Real estate allocation weight is kept at neutral. The low interest rate levels in Europe have in places driven house prices momentarily up, but in the long run a neutral stance is in place. In the US the constructors' own confidence index has bottomed but a significant level revision cannot be spoken of. House prices and trade amounts received a clear injection through the tax credit program at the end of May, but June's statistics have for the time being been very soft.

Alternative Investments

Private equity market is kept at underweight. Yet is not the time to add private equity significantly to portfolios.

Convertible bond weight is kept at neutral allocation weight. Falling stock prices have also weighed down convertible bond markets and an increase in weight is left for the future.

Hedge funds are kept at moderate overweight in our recommendation. Hedge fund managers are in a general inspection on the move with a quite careful position since the beginning of the year. Also currency-side hedge funds are bearing careful positions this year.

Commodities

In commodity markets, we are keeping our moderate overweight stance. Crude oil price has continued to rise and we anticipate the Mexico Gulf situation to keep crude oil price on the rise for a longer time. Especially industrial metals and the energy sector are vulnerable to stock market pricing and general risk willingness in the current macro environment. Agricultural raw materials new cultivated area statistics in the US shows austerity in cultivation and turned corn prices' downward tend dramatically. We anticipate agricultural raw materials to develop favorably during the summer. Index wise, the S&P Commodity index yielded a careful 0.75% in June, but year to date is still a negative 11%.

Market outlook (change to previous month)		Monthly recommendations 6/2008 - 7/2010*																									
		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
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
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
Europe government bonds: 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
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
High Yield and structured products: Moderate overweight	(=)	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
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
Inflation: Moderate underweight	(=)	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
Equities: Moderate overweight	**(-)**	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
USA: Neutral	(-)	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
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
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
Emerging Market Equities: Overweight	(=)	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
Alternvative Investments: Neutral	**(=)**	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
Private Equity: Underweight	(=)	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
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
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
Convertible Bonds: Neutral	(=)													4	4	4	3	2	2	2	3	3	3	3	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

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