

Market Outlook

May 2011

Earnings season passed by well – no sign of strong margin pressure yet

Stock markets recovered quickly after the turmoil in March, and the main exchanges made strong gains in April. In the U.S., growth was strong despite the weakening dollar, and only the negative outlook on the U.S. given by credit agency S&P caused unwillingness for risk taking mid-month. We held our equity weights at a neutral stance heading into May, but we are prepared to hedge the equity weights of our portfolios heavily if needed. The period of changing seasons into summer starting from May has often been weaker for stock markets than the winter period. The earnings season has gone exemplarily, and after a rise in equity rates, there is room for a correctional shift in the market. The rise of prices in commodities has not yet been seen in profit margins.

We maintain a moderate underweight in fixed income in our allocation, and a moderate overweight in alternative investments. Long-term interest rates fell slightly in April despite ECB raising its key interest rate. The interest rate went up by 0.25% and statements regarding future hikes were very moderate. The ECB expressed a desire to further raise interest rates if there is a growing pressure of inflation. We are expecting a few more rate hikes of 0.25% this year.

As we anticipated, Portugal had to turn to the EU and IMF for help and even the Finnish elections were taken note of by the market. We are keeping an eye on Spain's situation, where there were already signs of an unsuccessful auction of short-term bonds. Any struggling on Spain's part to auction bonds could have an immensely dampening effect on risk taking. The size of the current stability mechanism is simply not big enough to cover any support for Spain.

New corporate bond issues in Scandinavia have merely shone by their absence. There have not been any new notable issues. The financial situations of companies being at seemingly good levels and the lack of any new issues, has led to the further narrowing of risk premiums in the secondary market.

Share prices rose heavily in April, and in some cases, even pre-financial crisis levels were surpassed. For example, Nasdaq has topped the best levels of 2007, and emerging market exchanges have also had a good run. The ongoing earnings season has on the face of it gone well. Around 70% of reporting companies have exceeded consensus forecasts, and so far there is not much to mention regarding the feared margin pressures. We expect margin

pressures to be more visible in company earnings only in the second half of this year.

In addition to our neutral equity weight stance, we will add more weight to emerging markets. We will raise our emerging markets weight to moderate overweight at the expense of Europe. Within Europe, we will mainly lower weight in Finland and Scandinavia.

The overall picture of commodity prices has remained positive and S&P's raw material index has gained +16% since the beginning of this year. Oil has not been able to shift into lower levels, and only from the beginning of May were we able to see the price of silver at a slightly lower level after the immense gain in April (+31%). We are preparing to tactically lower the weight of commodities in our portfolios, but the timing has to be precise. As for agricultural commodities, the weight has already been lowered, and we are now carefully monitoring the price frame and fundamentals of energy and industrial metals. Raising our convertible bond allocation has borne fruit, and we will continue to maintain a moderate overweight.

Market Returns 31.3.2011

Fixed Income	Return 1m	Return 2011	Return 1y
JPM Money Mkt	0,09 %	0,39 %	1,17 %
JPM EMU Govt	-0,09 %	-1,22 %	-1,71 %
Barcleys Infl.Linkd	0,94 %	2,14 %	1,06 %
JPM Credit Index	0,71 %	0,19 %	1,20 %
JPM High Yield	1,83 %	5,31 %	11,00 %
JPM GBI EM Divers. (LC)	0,17 %	-3,08 %	4,28 %
JPM EMBI+ (HC)	1,38 %	2,23 %	9,49 %

Equity Markets	Return 1m	Return 2011	Return 1y
OMXH Mid Cap	2,07 %	5,71 %	15,26 %
Euro Stoxx 50	3,45 %	7,27 %	6,90 %
Stoxx 600	2,86 %	2,44 %	9,18 %
S&P 500	2,85 %	8,41 %	14,91 %
Dow Jones	3,98 %	10,72 %	16,37 %
Nasdaq	3,32 %	7,91 %	16,75 %
Nikkei	0,97 %	-3,71 %	-10,92 %
Hang Seng	0,82 %	3,14 %	12,38 %
India	-1,59 %	-6,15 %	8,98 %
Russia (RTS)	-0,84 %	14,50 %	28,87 %
Brazil	-3,58 %	-4,58 %	-2,07 %
MSCI Europe	2,75 %	2,39 %	8,81 %
MSCI World	4,82 %	8,64 %	16,77 %
MSCI Emerging Markets	3,10 %	5,73 %	20,67 %
MSCI Latin America	0,04 %	0,85 %	11,99 %
MSCI Eastern Europe	2,82 %	18,36 %	26,93 %

Alternative Investments	Return 1m	Return 2011	Return 1y
S&P Commodity TR	4,41 %	18,36 %	24,68 %
Oil (spot)	6,24 %	23,96 %	22,66 %
Gold (spot)	8,09 %	10,37 %	30,68 %
HFRX Global HF	0,49 %	1,37 %	3,17 %

Foreign exchange	29.4.2011	31.3.2011
EURUSD	1,481	1,416
EURJPY	120,22	117,690
USDJPY	81,19	83,130
EURGBP	0,89	0,883
EURSEK	8,95	8,952
EURNOK	7,77	7,842

Interest rate levels	29.4.2011	31.3.2011
Fed	0,25	0,25
ECB	1,25	1,00
BoJ	0,10	0,10
BoE	0,50	0,50
Euribor 3m	1,39	1,24
Euribor 12m	2,13	2,00
Germany10y	3,24	3,35
iTraxx Europe 5y (IG)	96,51	101,57
iTraxx Crossover 5y (HY)	352,66	384,37

Fixed Income

Past events

Interest rate levels remained below the beginning of month levels at the end of the month, despite the rate hike of the ECB. In the press meet after the rate hike, the ECB retained its watchful tone and repeated it to be ready for new rate hikes to contain inflation pressures. Realized inflation in the euro area has risen to 2.8%, which is clearly above the ECB target (2%). Thus, a few quarter of a percentage hikes for this year are not unheard of. Inflation swaps currently price a 2.33% level on average for the next five years in the euro area. The strengthening euro is also making things difficult for the ECB. The good pull of industrial production especially in Germany has managed to

ECB opened the rate hike game

avoid the greatest damage due to good export demand, but the situation is changing. Interesting is that, in Germany actually domestic demand has shown first signs of bending, thus clearly weaker performance has been visible on the household front.

Of other European countries, the rate hike in the UK was already priced well into the beginning of May interest rate meet, but the weak aggregate production level and the more moderate inflation figures have caused dramatic volatility in the short-end pricing on the UK curve, as a result of which the first rate hike of BoE has been postponed until after the summer.

Current situation

Portugal's 5-year government rate is already at 10% and in Greece the respective 5-year rate is at 15% while the 2-year Greece paper is trading at even over 20% yield levels. Markets are thus pricing bond restructuring. According to estimates a 20-60% cut in nominals for Greek bonds would cause a around 1-3% weakening of Tier 1 capital in Europe excluding Greece, but for Greek banks such a cut in nominals would be a catastrophe. Bank capital would plummet 40-80% downwards, thus the whole country and its banking sector would be totally paralyzed. A some sort of restructuring may be the only rational solution in this situation and the faster, the better for the situation in whole. The problem of course is that the situation for Portugal, Ireland and Spain, possibly in line, has not really eased since. For Spain, slight uneasiness has been visible in money

Portuguese and Greek government bond premiums continue to be in dramatic rise

market auctions. The 18-month T-bill auctions was not really a success at the end of April, thus attention will now focus on the success of the debt crisis battling Spain's auctions.

Nevertheless, corporate bonds have done quite well, in turbulent surroundings. Company cash reserves are net at good levels and many companies have taken care of sufficient liquidity to ensure the situation during the financial crisis will not repeat itself. The amount of loan emissions has been small, and in secondary markets this has been seen as strong demand. High demand is present especially for Scandinavian company bonds in Europe. The main part of industrial companies perpetual bonds are trading below 5%, a situation, which last prevailed in 2007. Demand for bonds thus continues to be very good in markets.

The future

The US central bank announced expectedly in its April interest rate meet, that it will terminate its quantitative monetary easing program (QE2), that is, the purchasing of government bonds from market in the summer of 2011. We do not anticipate large pressure upwards on the interest rate levels in the US due to the ending of the QE2. Interest rate levels have actually been declining since the end of April also in the US. The possible decrease in risk willingness in risk markets, the moderated oil and raw material price picture, the prevailing low refinancing rate level and the already risen interest rate level (30-year touched 4.65% at the beginning of April) has caused demand for US Treasury bonds in markets. The negative outlook given by S&P to the U.S. AAA credit rating has not at least for now, affected interest rates negatively, on the contrary.

Fed ending QE2 in the summer

We have opened USD risk also in interest rates in our baskets. In the Fixed Income Portfolio, USD hedge accounted for only 17% at the beginning of May. The robustly trade-weightedly strengthened euro combined with the weakened US dollar has driven the EURUSD currency couple too high, inspected in the short-run, in our opinion. Speculative euro-longs in derivative exchanges are also near all time highs, which mirror the different approach of the ECB and Fed currently. Nevertheless, positioning in markets is beginning to be too one-sided for the strong euro and we have now opened our dollar hedge in our portfolios.

Equities

Past events

Strong recoil in April

Equity markets were in quite a trance in April and only the setting of U.S. government bonds to negative outlooks caused slight sales-pressure mid-month, which quickly turned to a rise. In the history of S&P credit ratings, giving negative outlooks has with high probability led to the actual degrading of a credit rating, but this can take a long time. Since the beginning of the year, on both sides of the Atlantic, main exchanges have developed well in local currencies (S&P 500 +8%, EuroStoxx 50 +8%). In EM markets, Russia's pull has continued strongly while for example Brazil is stuck in place currently. The hawkish grip to raise refinancing rates has begun to slightly calm down, but for example in Brazil the 12% refinancing rate

and 5% real interest rate (after inflation) gives local investors some sort of interest yield.

The development of Finland has not been as good as for the European main exchanges. Also in Scandinavia, returns have lagged European development. Inspected sector-wise, the underperformance of finance and banking names against the main index still shines in both the US and Europe. Also in Europe, telecom companies' stock prices have continued in their underperformance. In the US, energy and technology companies have been winners against the main index. In our mandates and combination baskets we kept equity weights near neutral weight, to which it was raised to during the catastrophe in Japan mid-March.

Current situation

Earnings season passed well

The ongoing year's first earnings season is on its way globally and the up-until-now reported companies have on average exceeded consensus forecasts. In the US, positive earnings surprises compared to forecasts have been around 70% of companies and in Europe respectively 55%. The feared downward cycle of earnings margins has not been seen and only paper companies have communicated significant cost inflation (around 4-6%), information, which has led to the sales of paper companies after their earnings reports (UPM and Stora). The softening of margins on a market-wide level may be an issue for the second half of the year. The engineering sector has in whole been very strong in its results and the level of received orders has been very good especially in BRIC countries.

Telecom companies are trading at moderate multiples in exchanges and the weaker than expected earnings have weighed down prices. Of metals companies Rautaruukki and SSAB have been strong while one the stainless steel side Outokumpu's result still remained negative. In places, companies have been rewarded with stock price ascent after good earnings at least in Finland, are beginning to be near our target prices, thus we have eased some holdings based on fundamentals, such as Metso and Cargotech after earnings releases. When inspecting Europe's Q1 offering, noteworthy is that the whole year earnings-per-share growth percentage has been raved downward, from the year beginning 14% to 11%. In the US, the respective trimming has been upwards from 15% to 16%.

The future

After earnings, macro factors in driver's seat

The earnings season is beginning to end after the first week of May meaning that other factors than company specific issues will pull equity markets. The earnings season in itself was strong again, even slightly stronger than what we had expected but it is good to keep in mind that the first quarter of the last year was clearly worse than the other quarters. Despite strong results, companies have not largely changed their whole year outlooks as we had anticipated and kept them quite general, as is the case usually at the beginning of the year. Consensus forecasts have remained stable after earnings releases, implying that the end of year forecasts have actually been downgraded as this year's first quarter earnings have been mainly better than consensus forecasts. Now attention is moving to macro economic and different geo-

political issues, which have many dark clouds in sight. On the other hand, the acquisition market have continued to be active, which on its part, supports equity markets and we do believe that strong company balance sheets as well as growth willingness will lead to the continuance of acquisitions activity. On average inspected, the combined valuation levels of main exchanges are not very expensive in a historic perspective (S&P 500 12m forward-looking P/E 13.4 and EuroStoxx 50 10.2). The relative cheapness of equity markets for example against fixed income markets, is not in itself a main driver as the withdrawal of risk willingness from markets in the short run will happen very quickly in the current atmosphere.

Alternative investments

Real Estate

Regarding real estate, we are not making significant changes. Our neutral allocation weight is maintained.

Alternative Investments

Regarding private equity, we maintain our allocation weight at neutral.

We maintain convertible bond weight at moderate overweight to which it was raised at the beginning of April. Convertible bond markets have developed favorably as corporate bond suction has

kept up while at the same time the equity market has risen well in April.

Hedge fund weight we maintain at neutral. Our fixed income hedge fund choice has continued in its good performance. Volatilities have been declining in the nearest execution prices but against tail risks, volatilities have been rising.

Commodities

In commodity markets, we maintain our allocation weight at neutral. Many agricultural commodities long positioning with exchange data has decreased and we have eased agricultural commodity weight in our portfolios. Cost inflation is beginning to weigh down many food producers also in this phase of energy price development. Industrial metals and energy allocation in our baskets still hold ammo and currently we are inspecting suitable levels to ease our positions.

Market outlook (change to previous month)	Monthly recommendations 6/2008-5/2011*																																									
	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	4	5						
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	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	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	1	1	2	2	2	1	1	2	2	2	1	1	1	1	1	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	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3					
High Yield and Structured products: Moderate underweight	(=)	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	4	3	3	2	2				
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	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	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	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	4	4	4				
Europe: Moderate underweight	(-)	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	3	2	2				
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	1	2	2	2	2	2	2	2	1	2	2	2	2	2	2	2			
Emerging Market Equities: Moderate 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	5	5	5	5	4	3	3	3	3	4	4	4	4		
Alternative 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	3	3	3	3	4	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	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	4	4	4	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3	3		
Hedge Funds: Neutral	(=)	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	4	4	4	4	3	3	
Convertible Bonds: Moderate overweight	(=)																																									
Commodities: Neutral	(=)	3	3	3	1	1	3	4	4	4	4	4	4	3	2	3	3	4	3	3	4	3	3	4	3	3	4	4	4	4	4	4	5	5	5	5	5	5	4	4	3	3

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

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