

GENERAL INVESTMENT CLIMATE

The Economy

Over the summer months the belief in a strong economic recovery in Europe faded away. The German economy unexpectedly contracted in the second quarter, and France had to settle for zero growth over the first two quarters of 2014.

The situation in the Ukraine seems to be stabilizing, but reciprocal trade sanctions that were implemented between the European Union and Russia inevitably have a negative impact on the economy.

Fears of a further escalation of violence in the Middle East are not really helpful in restoring confidence.

The OECD has lowered its growth expectations for the industrialized countries, due to increasing geopolitical risks and the threat of deflation in Europe. For this year, the OECD now only expects an economic growth of 0.8 percent for the Eurozone, next year the economy is expected to grow by 1.1 percent. Growth expectations for the United States were also revised downwards, but with 2.1 percent growth this year and 3.1 percent in 2015, the American economy is expected to significantly outperform the European economy.

In Germany, producer confidence fell for the fifth consecutive month in September; the IFO index is now at its lowest level since April 2013. More and more economists are beginning to fear that this is not just a temporary slowdown of business dynamics in Germany, but that we might be evolving towards a lengthy period of economic stagnation.

Private consumption in Germany remains strong, thanks to the low unemployment rate and the gradually increasing wages, but the export is under pressure, due to weak demand from important European trade partners such as France and Italy, and the growth deceleration in China.

However, there are also some positive signs. German industrial production and manufacturing orders – rather unexpectedly – increased strongly in July. This could indicate that the German economy will return to growth in the third quarter.

In France, the government collapsed end of August, following a dispute about the right economic policy and the need for more austerity measures. Once again, it proves to be very difficult to implement fundamental reforms in France.

In the United States, the labour market had a rather difficult summer. Job creation in July and August remained well below expectations. As the condition of the labour market is the main criterion for the monetary policy of the American central bank, this (temporary?) weakening strengthens the Federal Reserve in its view that the American economy hasn't yet recovered enough to raise interest rates for the first time since the crisis of 2008. Most economists expect an increase of the interest rate in the second quarter of 2015 at the earliest.

Inflation in the Eurozone declined further to 0.3 percent in September, the lowest level in five years. The low inflation is mainly caused by the falling energy prices. In September, the oil price dropped below the psychological barrier of 100 dollars for the first time since the summer of 2013, due to the disappointing economic growth and lower demand out of China.

Deflation fears are mounting again. However, the substantial weakening of the euro should have a positive effect on inflation in the Eurozone, thanks to an increase of the imported inflation.

Money markets and exchange rates

The European Central Bank is stepping up its efforts in order to fight the lacklustre economic growth and the chronically low inflation in the Eurozone. The main interest rate was rather unexpectedly lowered by 10 basis points again early September, to an all-time low of 0.05%. More importantly, president Draghi announced that the ECB is prepared to inject up to 1,000 billion euros in the market, through a broad package of measures including the purchasing of asset-backed securities and covered bonds.

Due to the stubborn resistance of Germany, quantitative easing (the large-scale purchasing of government bonds) is still not an option for the ECB.

Whereas the ECB has to further loosen its monetary policy, the Federal Reserve is gradually turning off the money tap. The purchasing of government bonds was further reduced over the past months and is set to expire end of October.

Due to the diverging monetary policies on both sides of the Atlantic, the euro has spectacularly declined in value over the past months. On a quarterly basis, the euro lost nearly 8 percent against the dollar. At a level of about 1.26 dollar, the euro is at its lowest level since two years.

However, a weak euro is more than welcome to give the European economy some breathing space.

Stock Markets

Table 1.1 - General

	30-sep-14	30-jun-14 - 3 mth	31-mrt-14 - 6 mth	31-dec-13 - 9 mth	30-sep-13 - 12 mth
AEX	421,14	1,93%	4,45%	4,82%	12,33%
BEL20	3221,40	3,01%	2,92%	10,18%	14,96%
DAX	9474,30	-3,65%	-0,85%	-0,82%	10,24%
EU50	3225,93	-0,07%	2,03%	3,76%	11,50%
DJ	17042,90	1,29%	3,56%	2,81%	12,65%
SP500	1972,29	0,62%	5,34%	6,70%	17,29%
Nasdaq	4493,39	1,93%	7,01%	7,59%	19,14%
EUR/USD	1,2631	-7,75%	-8,27%	-8,09%	-6,62%
EUR 3 months	0,8300	0,6230	0,5170	0,5430	0,6050
EUR 10 year	1,0870	-0,3920	-0,8250	-1,1470	-1,0760

The stock markets had a rather mixed performance in the third quarter, especially in Europe. Whereas the AEX and the BEL 20 were able to book small gains, the Euro Stoxx 50 was virtually flat over the quarter, and the DAX dropped quite significantly.

The half yearly results of most companies were in line with or even above expectations, and in the second half of the year, European companies, and especially those which are active internationally, should benefit from the weak euro.

In the United States, all three main indices recorded quarterly gains, albeit modest. Both the Dow Jones and the S&P 500 reached an all-time high in the third quarter, and broke through the barrier of respectively 17,000 and 2,000 points for the first time.

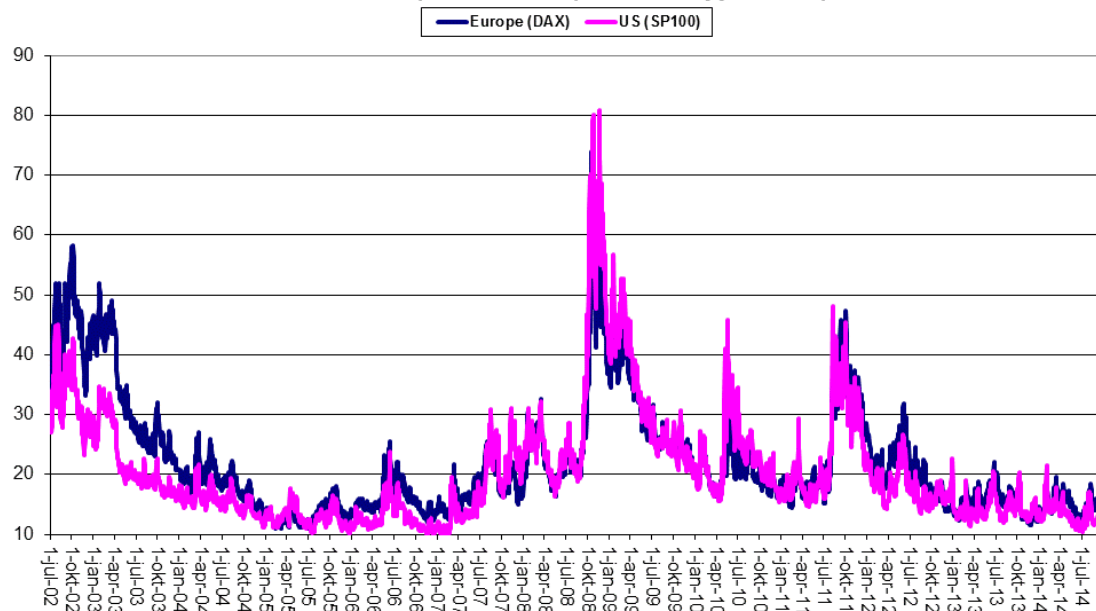
In the Netherlands, the small- and midcap indices both performed a lot worse than the main index. Whereas the ASCX was able to limit the damage somewhat with a loss of 2.3%, the AMX dropped more than 6%.

In Germany, the SDAX (-7.2%) and the MDAX (-4.9%) both recorded heavy losses in the third quarter.

Implied volatility

Despite increasing geopolitical tensions and economic uncertainty, volatility at the stock markets on both sides of the Atlantic remained at a relatively low level of about 15%.

Table 1.2 Development of the implied volatility jul 02 - sep 14



Long-term development

The AEX had a rather unsteady third quarter. After falling back to 390 points early August, the index recovered to above 420 points. On a quarterly basis the Dutch main index recorded a gain of nearly 2% and thus continued its positive trend of the past two years.

Table 1.3 Long-term development AEX jan 03 - sep 14

