

MERCER WEBCAST

Investment Markets Year to Date – Review & Outlook

July 16, 2014

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Head of Asset Allocation for Mercer's Delegated
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TODAY'S SPEAKER



Rupert Watson

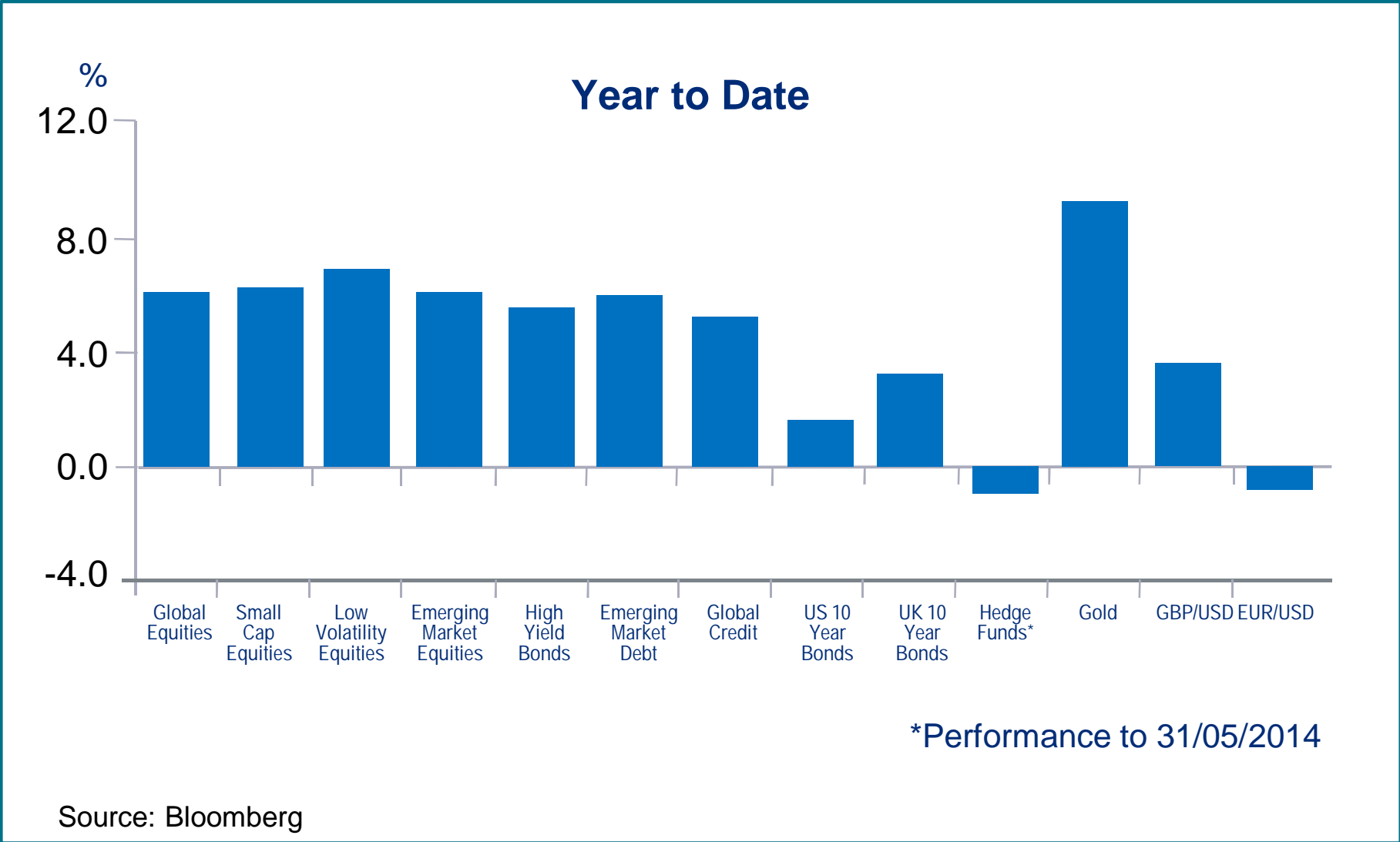
Head of Asset Allocation for Mercer's
Delegated Solutions Business in Europe

AGENDA - WHAT WE WILL COVER TODAY

- ❑ The year so far
- ❑ Economic growth accelerating into 2014H2
- ❑ Oil price impact of Iraq crisis muted so far
- ❑ UK booming, although inflation likely tame for some time
- ❑ ECB takes action. Too little too late?
- ❑ Bonds expensive, equities OK
- ❑ Is the long run outlook actually quite good?
- ❑ Questions

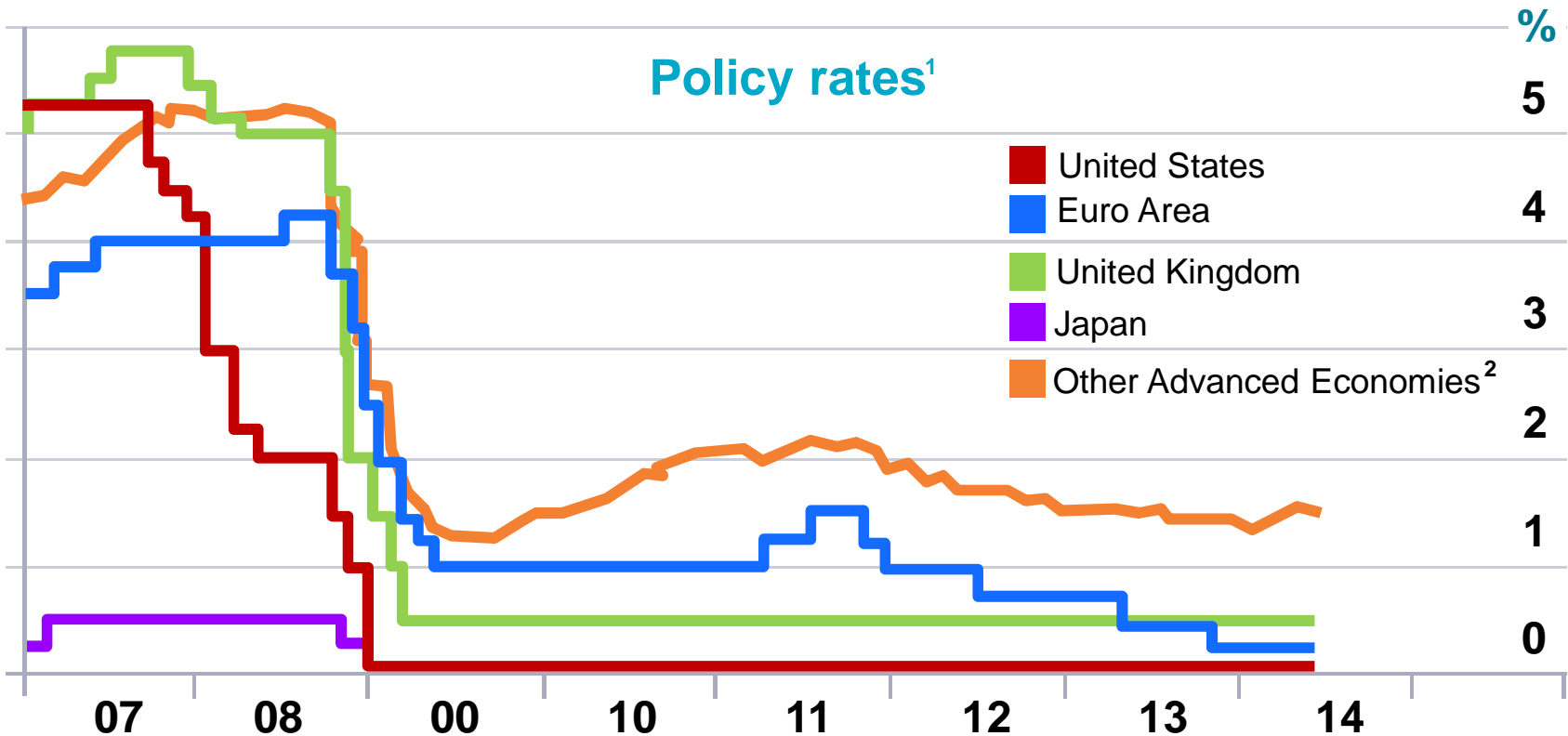


Dovish Fed supports all asset classes in 2014 H1



Central banks keep their feet on the accelerator

Accommodative policy in advanced economies holds down bond yields

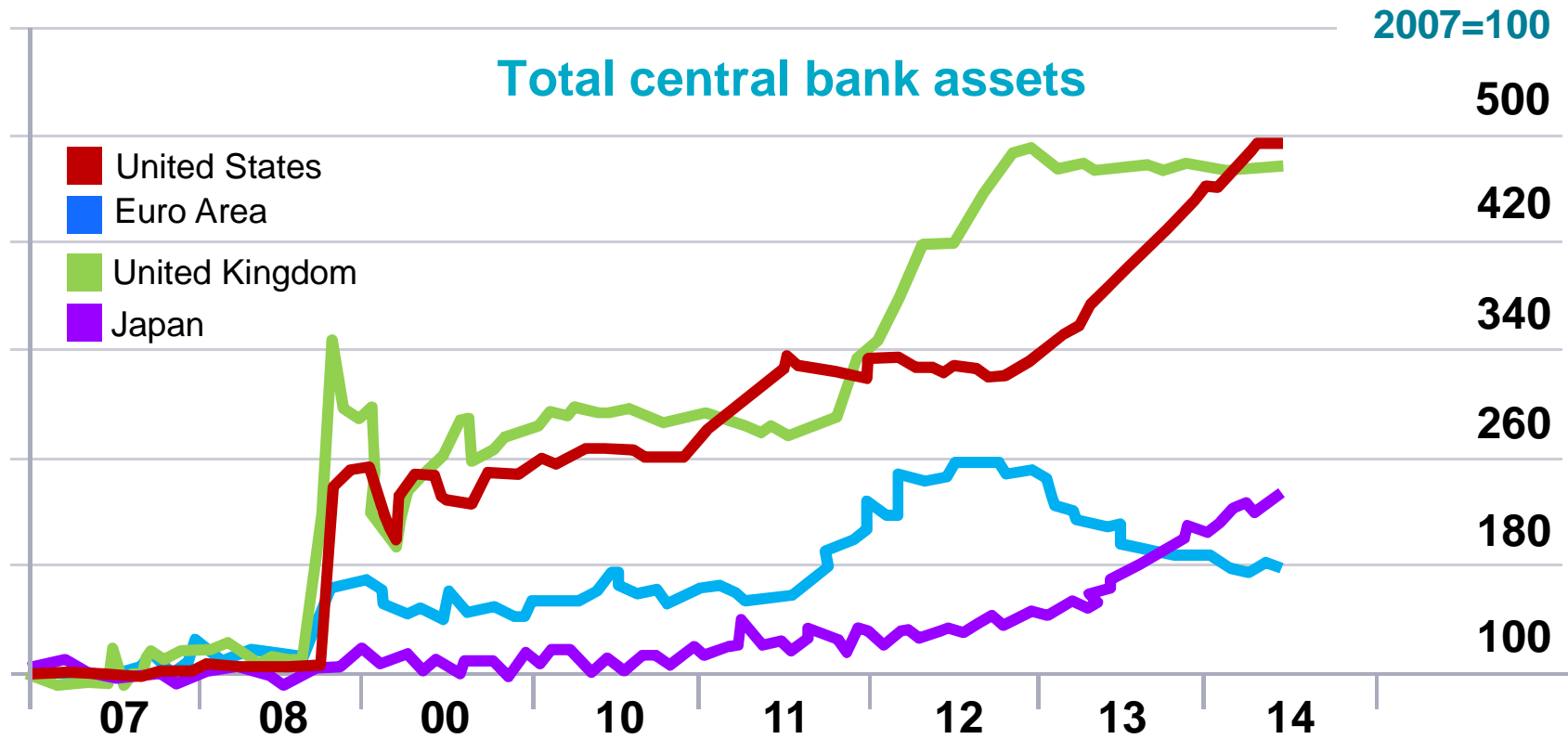


1. Policy rate or closest alternative for target ranges, the midpoint of the range, 2. Simple average of Australia, Canada, New Zealand, Norway, Sweden and Switzerland.

Source: Bloomberg; DataStream; National data; BIS calculations

Central banks keep their feet on the accelerator

Accommodative policy in advanced economies holds down bond yields



Source: Bloomberg; DataStream; National data; BIS calculations

Central banks keep their feet on the accelerator

Accommodative policy in advanced economies holds down bond yields



3. Based on monthly averages of daily nominal rates; simple average of the Euro area, Japan, the United Kingdom and the United States.

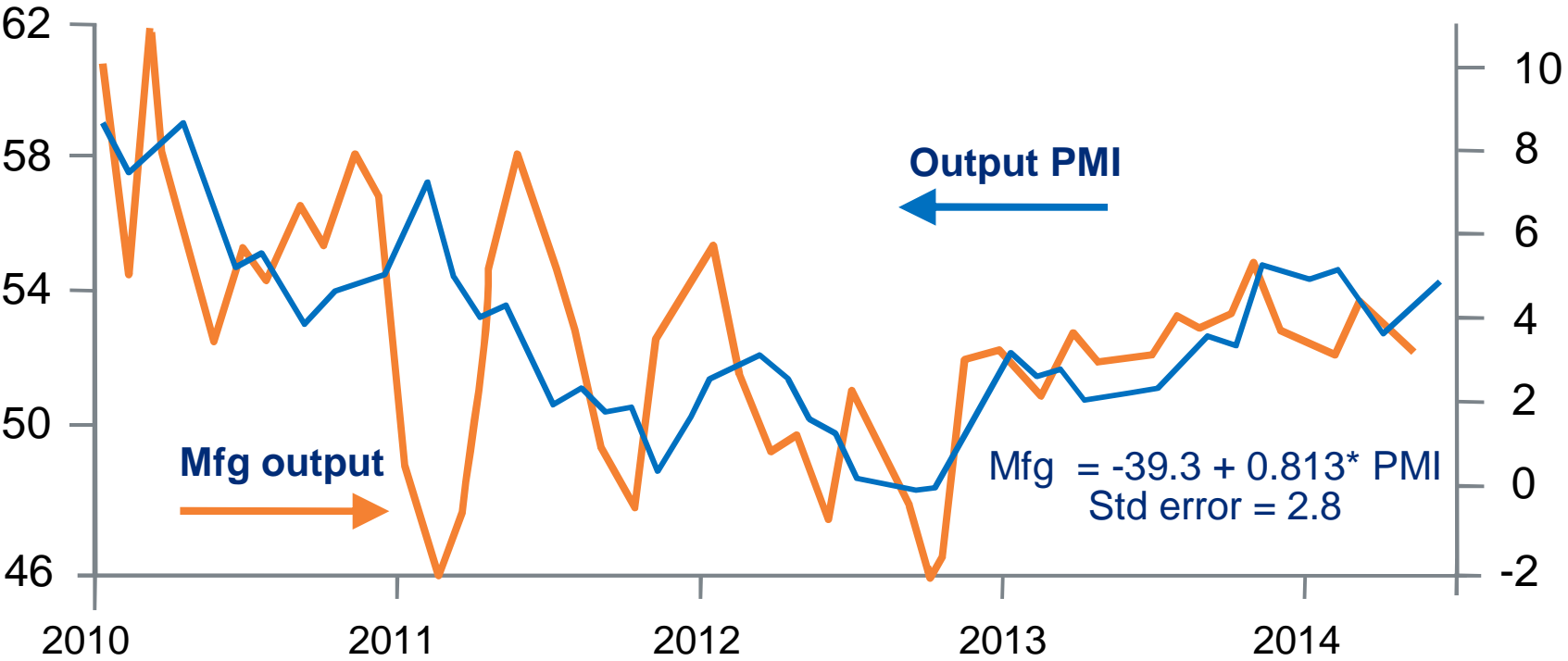
Source: Bloomberg; DataStream; National data; BIS calculations

Global economy accelerating after Q1 pause

Global manufacturing output PMI and actual output

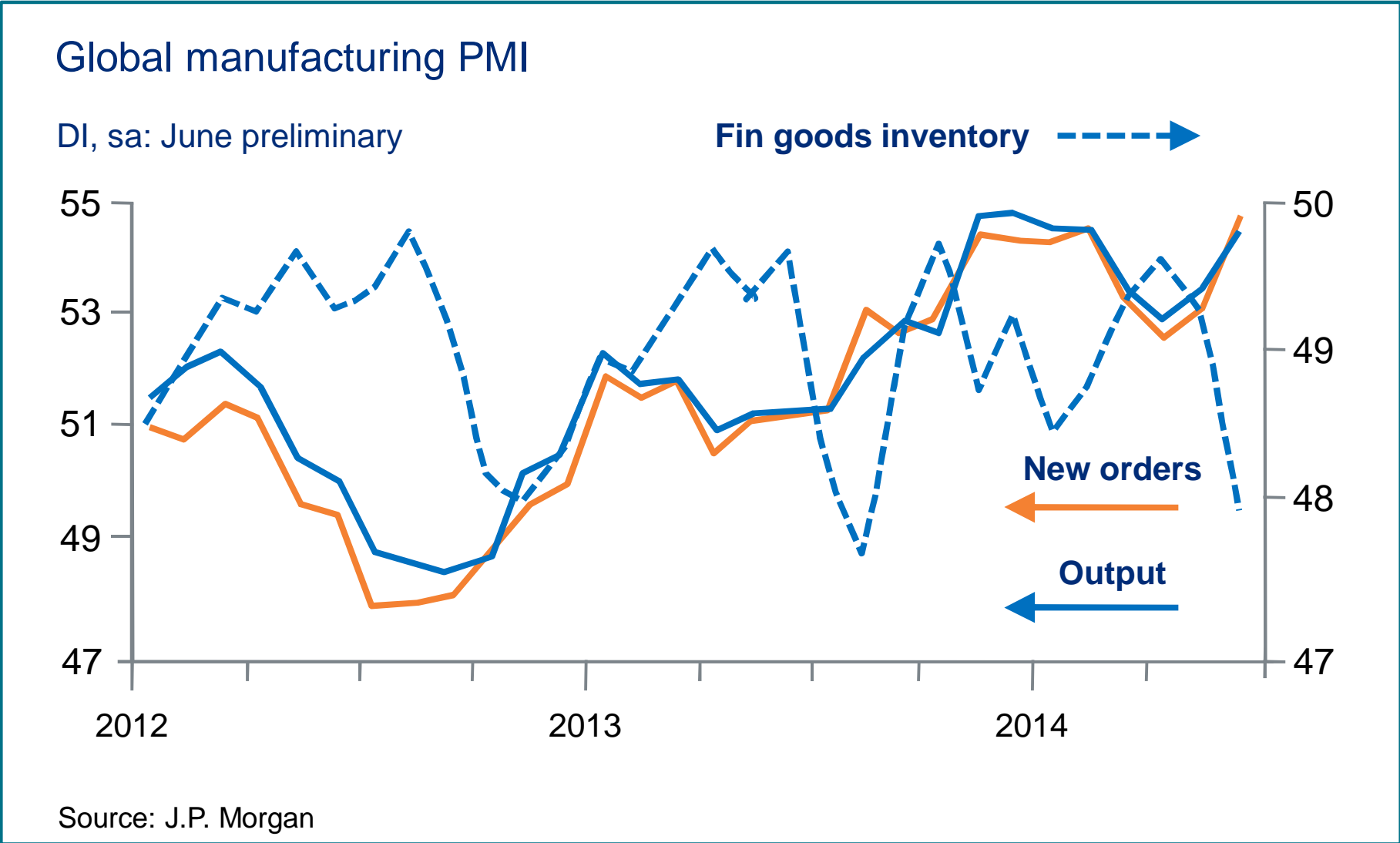
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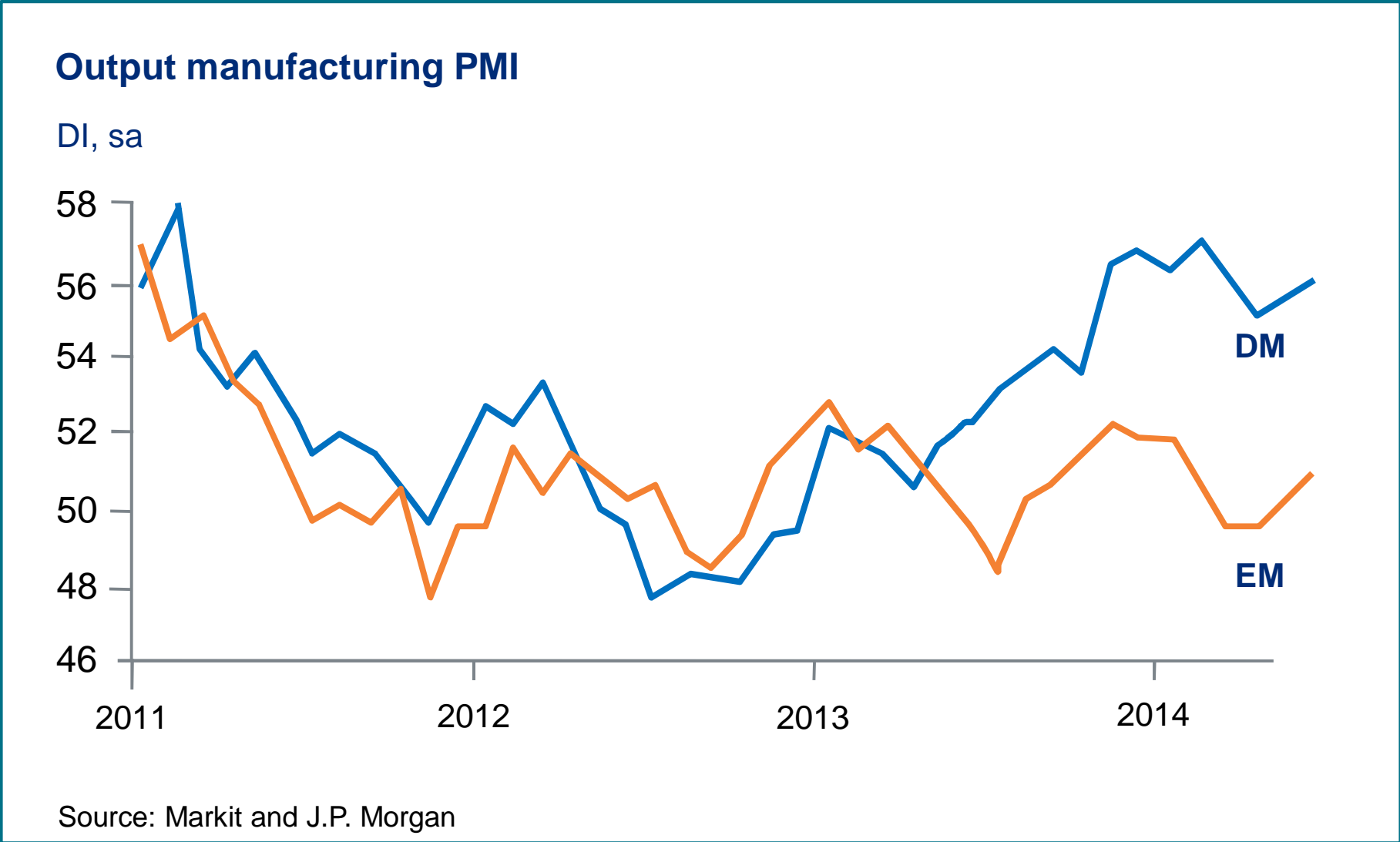


Source: J.P. Morgan

Global economy accelerating after Q1 pause



Emerging markets still lagging developed markets



Muted oil price reaction to Iraq crisis, so far

Brent Crude Oil Price: 12/01-6/14



Source: Bloomberg; Deutsche Bank

Muted oil price reaction to Iraq crisis, so far

Iraq's major oil fields & refineries in the south & east

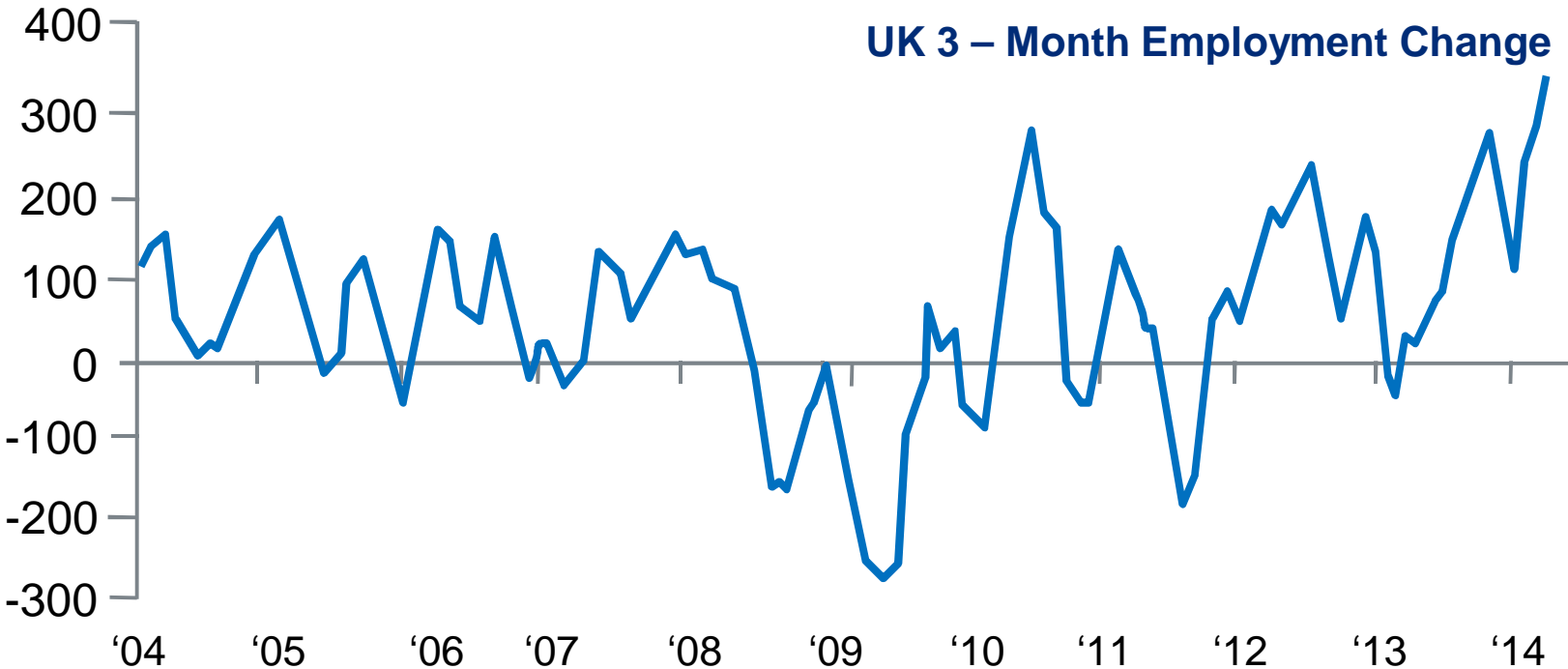


Source: Wikimedia Commons, Wood Mackenzie, Bloomberg Finance LP, Deutsche Bank Research

UK labour market booming

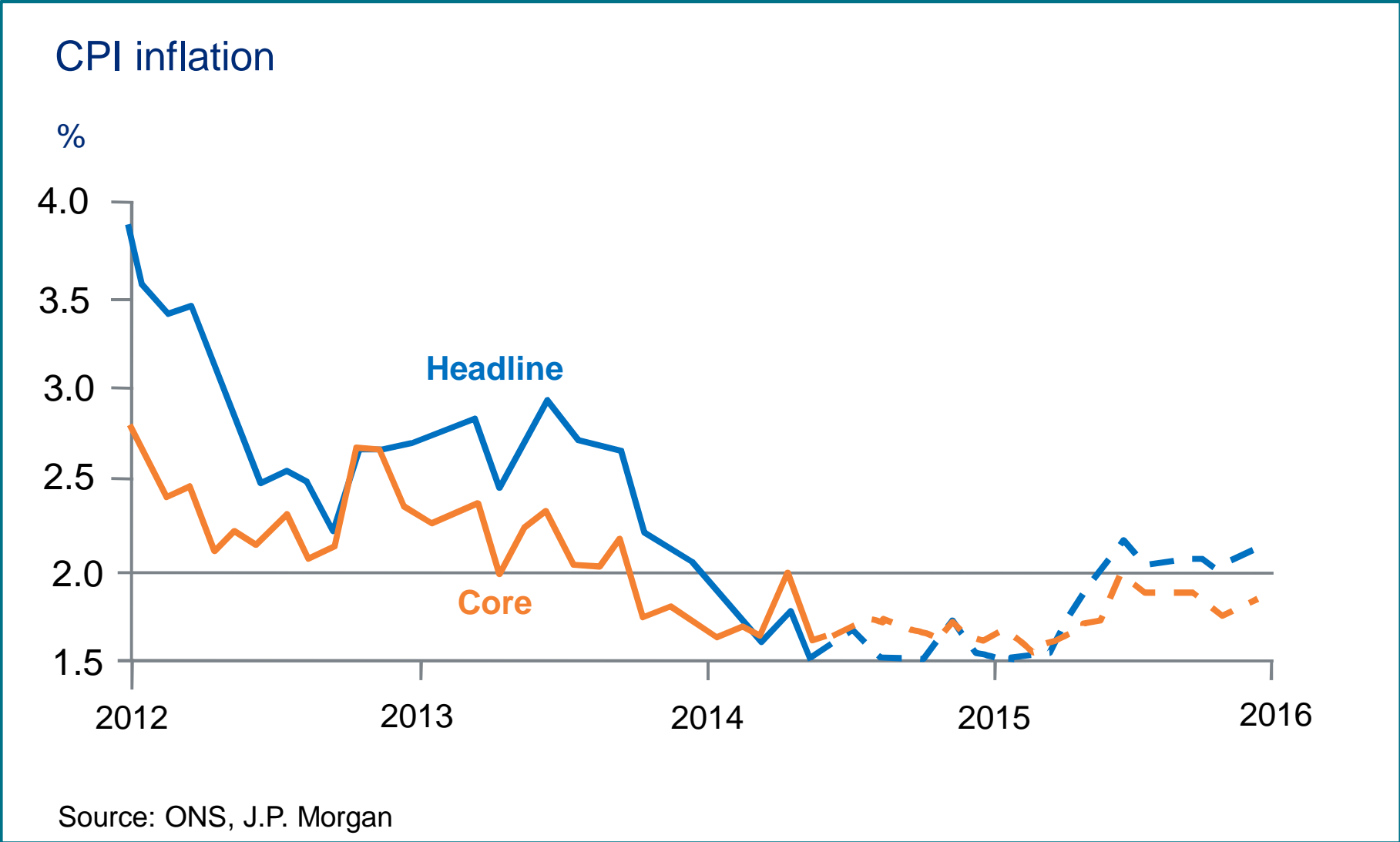
Growth in UK employment at an all-time high

Thousands



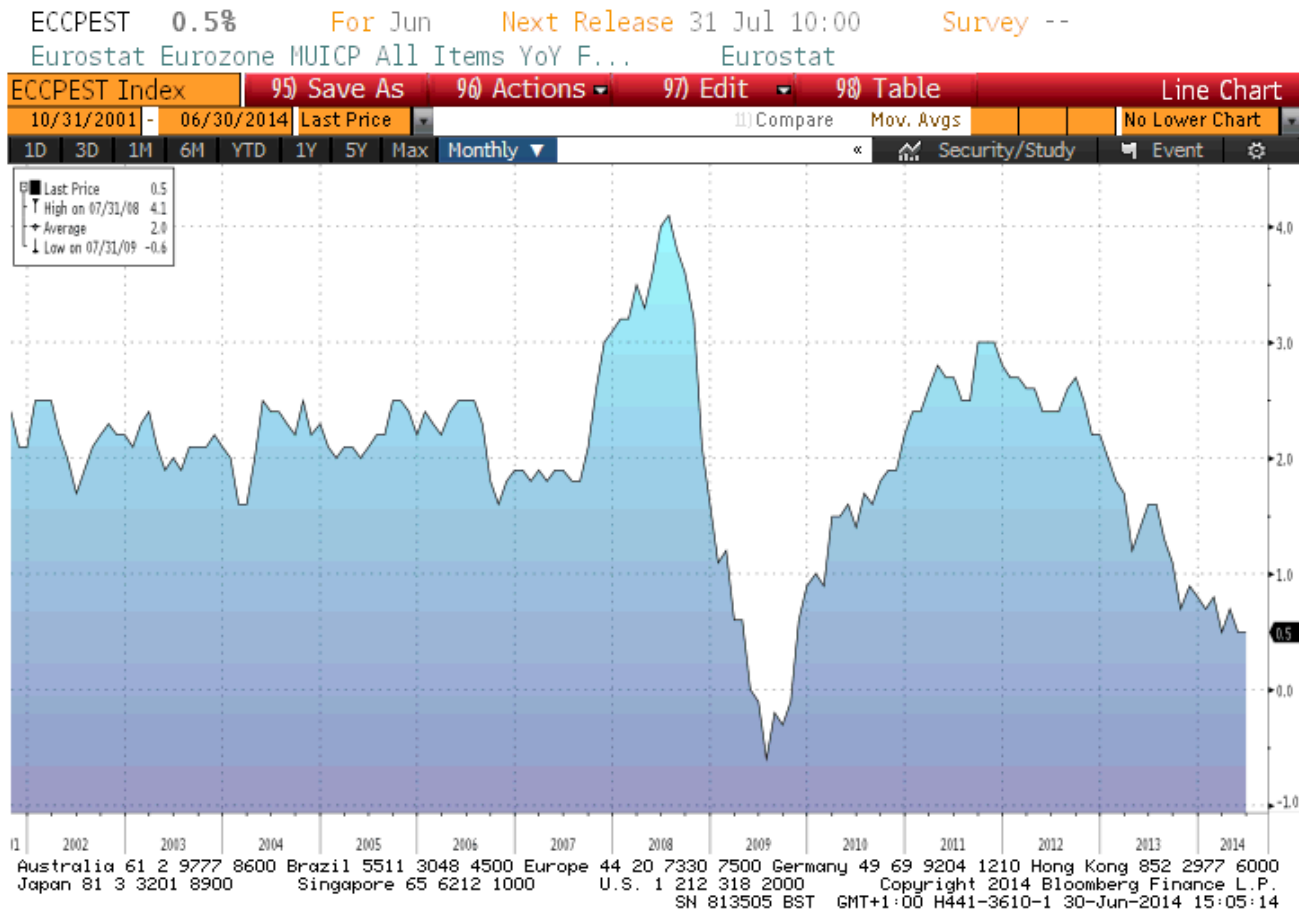
Source: Bloomberg, Goldman Sachs

UK inflation below target and likely to stay there



€urozone inflation fall prompts ECB to act (at last!)

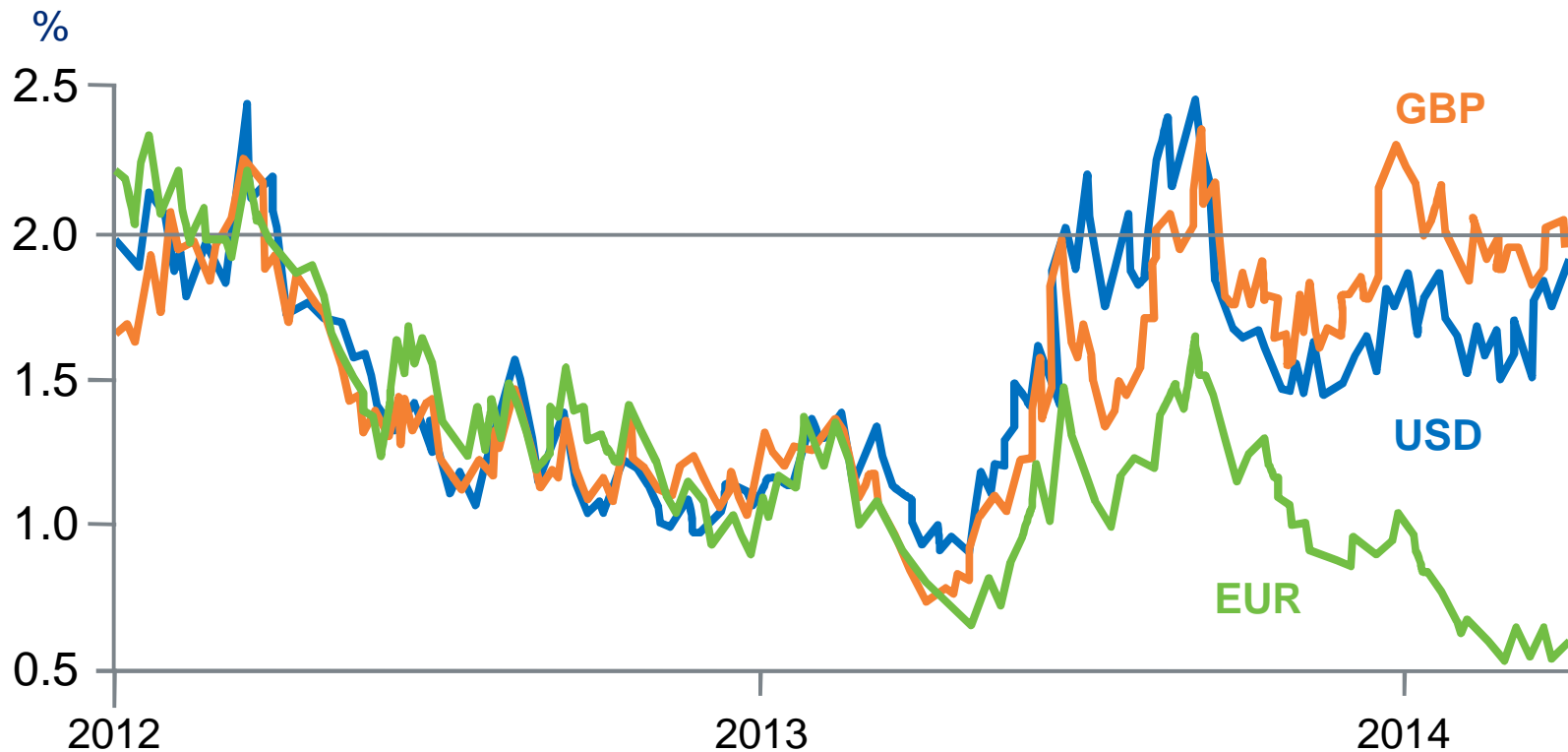
€urozone Inflation: 12/01 - 6/14



Source: Bloomberg

Interest rates likely to rise in UK/US. Not so in Eurozone

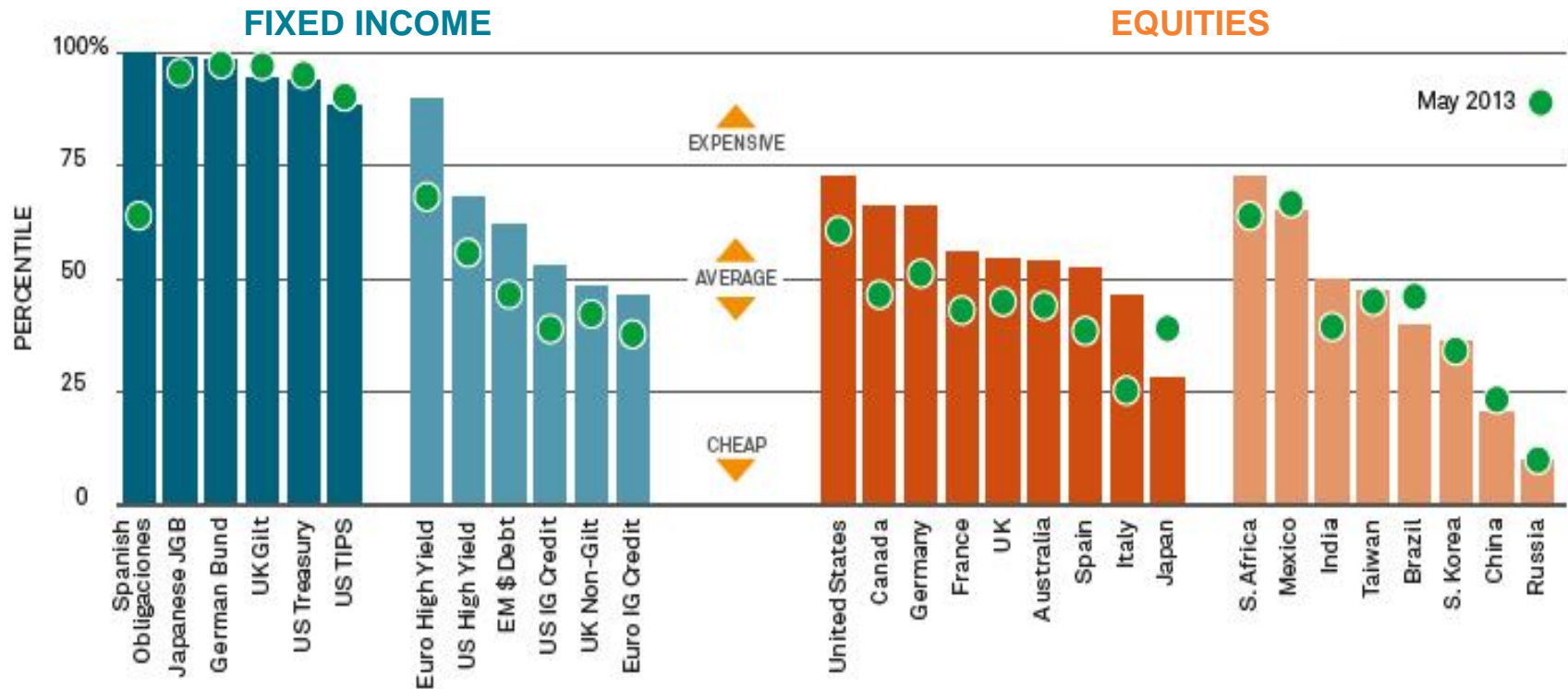
Current Market Pricing of end 2016 interest rates
Year-end 2016 forward 1mo OIS rates



Source: J.P. Morgan

Bonds generally expensive, equities mixed

Asset valuations by percentile vs. historic norms, May 2014

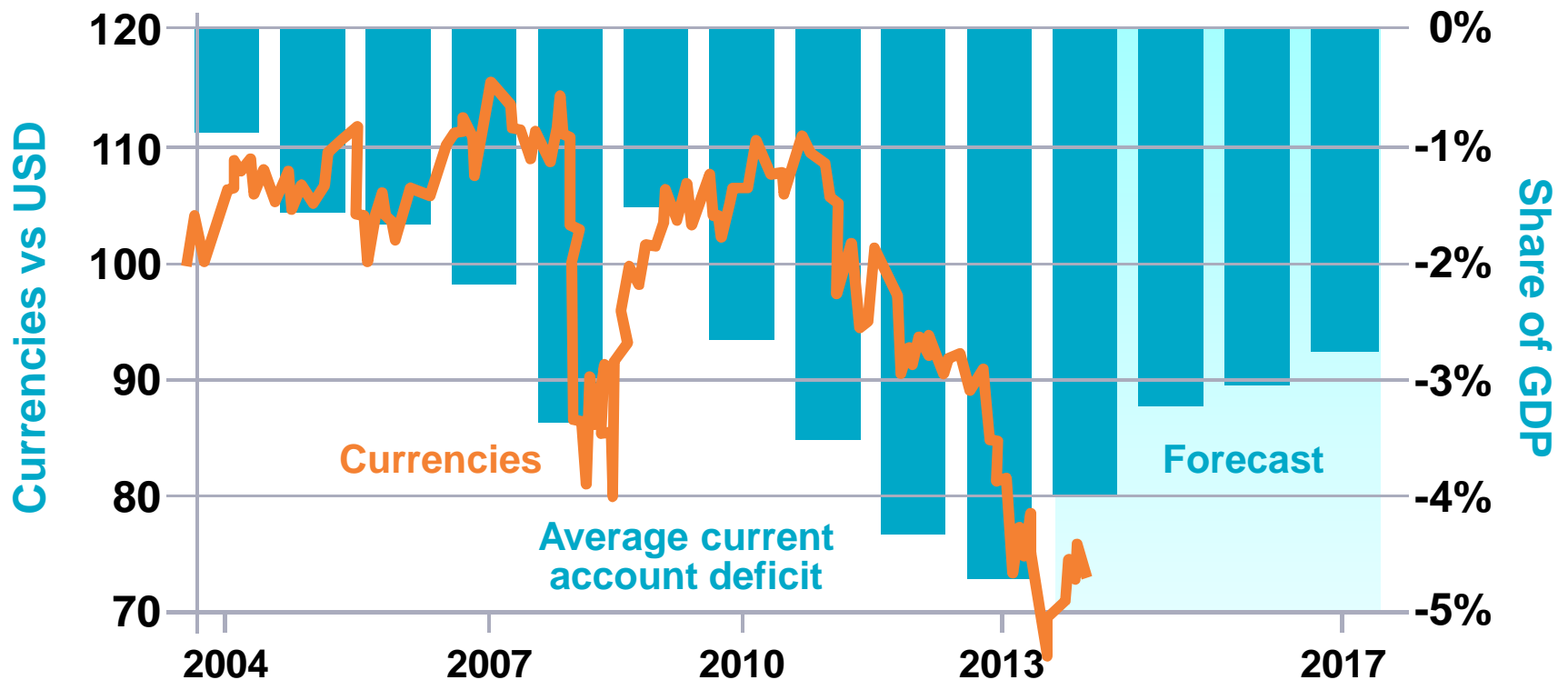


Source: BlackRock Investment Institute & Thomson Reuters , 30 May 2014. 30 May 2014. **Notes:** Valuation percentiles are based on an aggregation of standard valuation measures versus their long-term history. Government bonds are 10-year benchmark issues. Credit series are based on Barclays indexes and the spread over government bonds. Treasury Inflation Protected Series (TIPS) are represented by nominal US 10-year Treasuries minus inflation expectations. Equity valuations are based on MSCI indexes and are an average of percentile ranks versus available history of earnings yield, cyclically adjusted earnings yield, trend real earnings, dividend yield, price to book, price to cash flow and forward 12-month earnings yield. Historic ranges vary from 1969 (developed equities) to 1998 (TIPS).

Outlook for emerging markets improving

EM Re-emergence ?

Fragile five external deficits and currencies, 2004 - 2017



Source: BlackRock Investment Institute, Oxford Economics and Thomson Reuters, June 2014.

Note: The currencies line shows an equally weighted basket of spot rates vs the US dollar for the Brazilian real, Indian rupee, Indonesian rupiah, South African rand and the Turkish lira (rebased to 100 in June 2004)

“We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten”. **Bill Gates**

Pope’s inauguration 2005 & 2013



But "the beauty of our industry is that every 10 years it totally reinvents itself and we exceed our own expectations in the technology and the impact of technology on society."

And the things the company makes its money from can change within a year. "What could be more competitive than having 90% of your revenue in December come from products that weren't there in January?"

Craig Barrett, Intel Chairman 2009

The next 20 years

- Quantum computing
- Cognitive computing
- Robots
- Graphene
- 3D Printing
- Pharma

Summary

- Global economy accelerating. Growth likely to be decent for a few years
- Emerging economies lagging, but outlook for 2015 better. Reform key
- Inflation low and likely to remain low, allowing central banks to keep interest rates very low for some time
- However, the Federal Reserve and the Bank of England likely to start withdrawing some of the stimulus next year
- We expect equities to continue to rise, although at a slower rate than seen recently
- Valuations less favourable, although equities still relative to other assets
- Bonds yields to rise at a modest pace
- Long run outlook isn't as bad as some suggest

Questions



Rupert Watson

Head of Asset Allocation for Mercer's
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QUESTIONS

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