

2018 Outlook

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Markets have been very friendly for both equity and bond investors over the past few years. Trying to get the global economy back on track and dealing with the consequences of the sub-prime crisis, central banks around the world kept interest rates low (in some cases even negative) and pumped money into the financial system. Recession risk was low as a result. Risk of economic overheating was also muted as private investments only increased slowly, political uncertainty was high and consumer confidence was relatively low.

Combined with generally low inflation, this essentially provided a goldilocks scenario for investors and we expect this scenario to continue in 2018. There is one major difference however. As confidence in the robustness of the global economic recovery grew, central banks started to change policies in 2017, which we expect to continue in 2018. In this scenario, we see less liquidity provided to the markets and interest rates rising around the world. This is, on balance, continued good news for 2018 expected equity returns, but could be more negative for bond investors. Geopolitical risk remains the biggest risk for global markets, particularly the tensions between Iran and Saudi Arabia. In Europe, national elections may intensify the debate around a

further break-up of the European Union.

Our investment thesis is built around the conviction that our society is going through four major transitions and that each of these transitions will have huge consequences for how our economy is organized. The first transition is driven by demographics, with an ageing population, the rising importance of millennials and women in our economies, urbanization and a rising middle class in emerging countries as the main drivers. A second transition is environmental with the urgent need for solutions to climate change and natural resource depletion. A third transition is technological in nature, with tech playing a more important role in all aspects of our lives. And finally, we are also going through a major transition in terms of governance, both for states and for businesses, who have to deal with a crisis of globalization and act together in the general interest and for the common good. We see the polarization of politics in 2017 as further evidence that those transitions are becoming more and more visible. Those issues have been the major subjects of political debate in recent times: local focus vs globalization; older vs younger population; cities vs rural areas; men vs women, etc.

Our ability as a society and an economy to deal with those transitions at a sustainable pace will be the key to success. The solution is not polarization, but cooperation. It is not a question of going back to the old economy, but of investing in education, focusing on gender equality, collecting fair tax payments, etc. We believe that these subjects will become increasingly important drivers of investment returns in 2018 and beyond. The #MeToo movement and the

announcement by Facebook to start booking revenues in the countries where they are generated, which should lead to higher tax income for the countries involved, are recent evidence of this.

This has both positive and negative implications. Investing in broad markets also means owning stocks and bonds negatively exposed to the aforementioned transitions. Investors will need to keep in mind these transitions when building their portfolios. For 2018, we see good investment opportunities in Energy, Resources (Water), Technology, and Healthcare.

The continued global economic recovery should lead to increasing demand for energy and water. We expect oil prices to rise, which would make alternatives more cost competitive. Moreover, the need for solutions to climate change and natural resource depletion, combined with the fact that technological progress has made energy efficient solutions and renewable energy sources cheaper and more reliable, should lead to increased demand. We expect political disagreement on renewables in the US to lead to increased volatility, but do not expect that to have a significant long-term negative impact. On the contrary, any pullback could provide a good entry point. We also expect the providers of industrial water solutions to do well as CAPEX investments are expected to accelerate in 2018.

There has been a lot of debate about tech valuations in 2017. While valuations are certainly not cheap, we do not believe they are anywhere near bubble levels. We also believe some investors are underestimating the need for our economy to integrate high tech solutions in order to be able to compete over the long run, and trends like big data and cloud computing will only accelerate this need. On the other hand, as most tech companies barely pay taxes on their income, the debate on fair tax treatment, especially in the European Union, may reduce the speed of earnings growth in 2018 and beyond.

Finally, healthcare stocks experienced a difficult 2017, driven by the lack of visibility on healthcare reform in the US and general pressure on prices globally. Companies have taken action however, by reducing their cost base, and valuations have pulled back to attractive levels.

For bonds, the scenario is slightly more negative. We expect rates on longer-term debt instruments to trend higher in both the US and Europe in 2018, albeit in a continued low inflation scenario. We also expect central banks to continue to increase short-term interest rates (not expected for the ECB in 2018) and reduce their bond repurchase programs, which will only be partly offset by higher demand for income generating assets by the retiring baby boomer generation. As such, we anticipate that investors will be looking for alternative (higher) income generating assets such as infrastructure. This increased demand for infrastructure investments should balance the negative impact that higher bond yields may have on infrastructure valuations. Other investors will be looking for alternative definitions of return, accepting low bond yields when combined with other measurable positive returns, such as social or environmental returns. The financial crisis of the last decade increased banks' capital requirements and decreased banks' ability to finance environmental and social projects; this bodes well for the burgeoning green bond markets, which we expect to continue growing in 2018.

Long may the goldilocks scenario continue.

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