Investment update, third quarter of 2021

For the first time in almost a year, share prices fell significantly in September. However, the impact remained limited throughout the third quarter. Market interest rates also remained virtually unchanged during that period. While economists still expect the global economy to grow this year, the downside risks seem to be increasing. In this investment update, we look at the economy's past performance and its future.

Looking back at the economy

The global economic recovery is continuing. The number of infections and corona restrictions is decreasing, mainly in the developed countries. Economists are still expecting the global economy to grow this year compared to last. We will discuss the impact of the downside risks on this scenario later in this report.

Higher inflation

Inflation has risen sharply in recent months: in the US to 5.3% and in the EU to 3.4% compared to a year ago. In recent years, inflation has been between 0% and 2%. This increase still appears to be temporary. But what has caused it? The increase is mainly due to a number of cyclical factors:

1. lower prices in 2020
2. shortages on the supply side, e.g. computer chips
3. higher oil and gas prices
4. pent-up demand in 2020 that is now being expressed
5. sizeable support from central banks and governments

For high inflation in the long term, there needs to be what is known as a wage-price spiral. In this situation, higher prices lead to higher wages, which in turn lead to higher prices. We do not see this happening yet.

Emerging markets remain vulnerable

The emerging markets in general appear to be vulnerable. Vaccination rates are still low and central banks and governments are less able to support their economies. This has meant a slower pace for the economic recovery. It may also make it easier for new variants of the corona virus to emerge, leading to possible new

restrictions and, in the worst case, lockdowns. Could this have an impact on the developed countries? Yes, because many international trade and production chains pass through emerging markets, especially Asia.

In addition, emerging markets are exposed to US interest-rate policy. If US interest rates rise by more than expected, capital could flow out of the emerging markets as the interest-rate differential between the two areas narrows. Among other things, a capital outflow will lead to a depreciation of local currencies. This could cause a local financial crisis, as some emerging markets have significant debts in foreign currencies, for example Turkey, Argentina and Indonesia.

How did the financial markets perform?

Stock market returns were modestly positive over the third quarter as a whole. However, this varied from region to region. Long-term interest rates, and thus bond yields, remained virtually unchanged over the same period. Nevertheless, there were strong price movements in the meantime, in both shares and bonds.

A turn in stock market sentiment?

After a long period of almost continuously rising share prices, share prices on most stock exchanges fell in September. This turn in stock market sentiment was not only the result of higher interest rates. The problems at the Chinese property developer Evergrande (see Outlook) also had an impact. The biggest blow in the third quarter occurred in emerging markets (-6%), mainly driven by the decline in the Chinese stock market. Returns on US (+3%) and European stock markets (+1%) were slightly positive.

Long-term interest rates almost unchanged

In the first half of the third quarter, market interest rates in both Europe and the US fell by about 0.25%. This picture reversed in the second half. As a result, the overall impact on government bond prices remained limited. Corporate bond yields were also virtually flat. The relatively riskier high yield bonds performed slightly better than the relatively safer corporate bonds. European government bonds have been the worst-performing asset class so far in 2021, as bond yields are still higher than at the beginning of this year. And as you know, the price of a bond always moves in the opposite direction to its yield.

Returns for the Employee Pension

What has been the impact of these developments on the returns of the a.s.r. investment profiles? The realised returns are shown below.

Realised returns for investment profiles for Employee Pension in Q3 2021

Age	**Defensive**	Benchmark	**Neutral**	Benchmark	**Aggressive**	Benchmark
45 years or less	**12.19 %**	11.69 %	**13.95 %**	13.35 %	**15.42 %**	14.93 %
55 years	**5.17 %**	4.78 %	**12.94 %**	12.38 %	**15.42 %**	14.93 %
65 years	**- 2.98 %**	- 3.24 %	**- 0.53 %**	- 0.87 %	**1.12 %**	0.78 %

The returns shown are calculated to the end of September 2021.

The returns shown are net of fund charges but exclude investment administration fees charged by the Employee Pension.

The benchmarks for our investment profiles have been composed proportionally.

Past performance is no guarantee of future results. Still, we will try to offer a little more perspective from now on by also showing long-term returns for our investment profiles.

Realised return for investment profiles Employee Pension

	3-year return			5-year return		
Age	Defensive	Neutral	Aggressive	Defensive	Neutral	Aggressive
45 years	9.84 %	10.76 %	11.58 %	8.70 %	10.12 %	11.27 %
55 years	7.95 %	10.24 %	11.58 %	6.54 %	9.70 %	11.27 %
65 years	5.29 %	7.00 %	7.98 %	2.97 %	4.88 %	6.60 %

The returns shown are calculated to the end of September 2021.

This table shows the average annual returns of the investment schedules corresponding to the investment profiles and ages indicated for the specified period. For example: assume a participant is now 55 years of age and the table shows the 5-year return. This means that the returns and

investment schedules of the four years preceding 55 years are included in the calculation of this average return.

Outlook

Economists are still assuming that the global economy will recover. But in the near future, there appear to be more downside risks to this scenario. For example, the corona crisis could flare up again. And we have already described the precarious situation in emerging countries. We also see a number of other risks.

Expected phase-out of support measures

The scaling back of stimulus measures without damaging the economic recovery is a very delicate process. Central banks and governments have not always been successful at this in the past.

It is likely that central banks will prefer to reduce their bond purchase programmes rather than raise interest rates. The economic recovery is still too fragile for the latter. It therefore seems unlikely that the central banks will intervene by raising interest rates in the short term. But with (the announcement of) all possible measures, caution is required to avoid shocks in the financial markets.

Growth slowdown in China?

Another risk is the possibility of slower growth in China. In September, sentiment on the financial markets was largely determined by the Chinese real estate giant Evergrande, the third largest property developer in China. Evergrande is having problems paying the interest on its outstanding loans. The risk here is not so

much that American or European investors will invest heavily in this company, but the situation with Evergrande may be a first sign that the huge debt mountain of the Chinese economy is starting to have an adverse effect. This could lead to a financial crisis in China, resulting in an economic recession. Given that China now accounts for roughly one-fifth of the world economy, this would have global consequences.

a.s.r.'s view

The shape of the economic recovery, rising inflation and the expected unwinding of stimulus measures appear to be the main themes for the coming quarter. Economic recovery, inflation and higher interest rates are, in principle, favourable for relatively risky asset classes, such as shares. In contrast, these developments will not favour government bonds. We expect corporate bonds, like shares, to benefit more from the economic recovery than government bonds.

On the other hand, the real estate woes in China, lagging vaccination rates in emerging markets and the possible reduction of government support in developed countries may cause more volatility in the stock markets.

Since equity prices have fallen somewhat since last quarter, shares have become relatively cheaper and government bonds have become more expensive. So, given rising inflation and higher interest rates, we have a slight preference for shares over government bonds. For this reason, we will maintain our slight overweight in this asset class in the coming quarter.

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