FUNDAMENTALS

VIDEO TRANSCRIPT

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AVIVA INVESTORS

Hello and welcome to Fundamentals from Aviva Investors.

In this programme, we'll look at some of the key themes that we anticipate will exert a critical influence over financial markets for the foreseeable future. Themes that will affect the way we invest our clients' money.

We'll explain how and why we think factors such as geopolitical instability, or the triumph of reflation over deflation, could shape the global economy and financial markets in the coming months and years.

But first, I'd like to welcome Michael Grady, Senior Economist and Strategist at Aviva Investors.

Hi Helen.

Michael, can you explain to me how the strategic themes drive the investment process at Aviva Investors?

Sure, the themes reflect a collective view from across Aviva Investors' investment teams both here in London and around the world. We believe these themes will be important drivers of financial markets and therefore provide a framework for our investment decisions.

So, how often do these investment themes change, or are they longer-term?

Well they are longer -term drivers, but they're not intended to be exhaustive, nor cast in stone. We have regular, formal forums in place where we review and assess any potential risks against a backdrop of fluctuating markets, changing economic conditions and geopolitical turmoil.

Thanks Michael. We'll come back to you for more later in the programme, but now let's take a look at the first of the themes Michael has just mentioned - extended monetary accommodation. Stewart Robertson, Senior Economist at Aviva Investors, joins us from Aviva Investors' London office to give us an insight into policies across key global markets.

Thanks Helen. When the US Fed raised rates in December 2015, it provided guidance that it expected to deliver four further hikes in 2016 and something similar in 2017.

Since then a combination of global concerns, including the Brexit vote, fears of a hard landing in China and European banking concerns, as well as a few domestic wobbles, has prompted an extended period of global monetary accommodation.

We now expect to see only two more hikes by the end of 2017. Elsewhere, the Bank of England has already cut rates and restarted quantitative easing, while we expect the European Central Bank to extend its asset purchases beyond March 2017. We also believe a

significant fiscal package will accompany increased asset purchases by the Bank of Japan in the coming months.

This extended period of global monetary accommodation should allow the shift from monetary tightening to easing to continue in the emerging economies while they implement further structural reforms. But while looser monetary policy should be maintained globally for some time, the effectiveness of further easing remains questionable.

Thanks Stewart. Turning to the next theme, Mary Nicola joins us from Singapore to discuss the prioritisation of growth in China.

Thank you Helen, I'm delighted to be able to join you. For some time Beijing's policymakers have said that the country needs to undergo an economic transition from an ultimately unsustainable model supported by government investment and exports, to a more sustainable one driven by innovation and household consumption.

However, with the beginning of that transition leading to a more significant slowing in growth than anticipated, it has become clear that the authorities are determined to prevent growth from falling below their target of 6.5 per cent. Beijing has unveiled a whole raft of initiatives designed to prevent a protracted slowdown that the government fears could prove destabilising.

For the time being therefore, it appears that the focus on growth will take precedence over the reform agenda. The new stimulus measures should ensure that growth stabilises in line with the government targets. However, this strategy could store up much greater problems further down the road, exacerbating the already large debt overhang there, raising the prospect of more serious problems in the banking system.

Thanks Mary. Now let's look at the global economy, where the battle between reflationary and deflationary forces continues to be a key driver of markets. Michael's here with us to discuss the main drivers.

So can you tell me what the most important global themes are?

Well we think that one of the most important global themes over the next couple of years is the extent to which recent disinflationary, or even deflationary, trends seen around the world are likely to persist; or instead whether reflationary forces begin to re-assert themselves.

The global financial crisis of 2008 drove the world into a deep recession, creating so much spare capacity that even extraordinary monetary stimulus was unable to prevent a disinflationary impulse. Much of that excess capacity has been steadily eroded over the past 8 years, although slack remains in the euro area and some other developed markets. Meanwhile emerging market economies, in particular China, have both over-invested – increasing excess capacity - and have seen growth slow, this has put downward pressure on commodity prices.

So what about other areas of the world, the US for example?

Well, in the US, the recovery is more advanced, slack is almost completely eliminated and core inflationary pressures are steadily building. Core Consumer Price Inflation is back around its pre-crisis average, and we expect that continued loose monetary policy for the foreseeable future will support the recovery in major economies, reducing slack and spurring inflation. Alongside a stabilisation in commodity prices, we expect to see headline inflation rates moving materially higher in the second half of 2017.

So, are there are any other factors that could affect inflation?

Well structural headwinds, such as technological change will likely continue to put downward pressure on inflation. But with the exception of Japan we do not think that longer-term inflation expectations are worrying. At this point we think that reflation will ultimately triumph over deflation.

Thank you Michael. Well you've touched on commodities there. Next up, I'd like to hand over to Kevin Gaydos in Chicago who's going to to take us through the outlook for commodity prices.

Thanks Helen. The sharp fall in oil prices in 2014 and 2015 prompted concern about the global economic outlook that affected equities and other asset classes. Investors worried about the earnings of energy companies, miners and banks exposed to the commodity sector's debts.

However, on this occasion, we do not think that falling oil prices are a harbinger of global economic weakness. An increase in the supply of oil rather than a lack of global demand has been the main factor driving oil prices sharply lower. We expect that some slowing in supply, particularly out of the US, alongside an improving global demand picture should see oil prices stabilise, albeit well below the levels seen prior to the collapse. One factor keeping supply more abundant is the fall in the breakeven price of extraction. Technological advances have meant that it remains economic to continue drilling for shale oil at much lower oil prices, potentially even $30 a barrel.

We believe we will continue to see variations in price trends across the commodities market. The economic transition taking place in China, which has historically accounted for over 50 per cent of global demand for commodities such as iron ore, will be a key driver of this dispersion, alongside commodity-specific supply conditions.

Thanks Kevin. Our final theme is geopolitics. We're joined now by Trevor Leydon, Head of Investment Risk and Portfolio Construction at Aviva Investors.Trevor, is geopolitical uncertainty growing and does it pose a threat to investors?

Well Helen, the global financial crisis led to rising unemployment, falling living standards and widening inequalities which have caused a rising tide of nationalism and greater geopolitical instability. This has been reflected in the US presidential campaign, the rising popularity of nationalist parties in continental Europe, and during the UK's referendum campaign on EU membership. Nationalists tend to reject

globalisation and collective risk-sharing, with potentially significant implications for international trade and finance.

Key events include the Italian referendum on constitutional reform in October, the US presidential election in November, the French presidential election in April 2017 and the German general election, likely to take place in October 2017. The outcome of the UK referendum may have increased the potential for market volatility around each of these events.

At the same time the rise of China, and an increasingly assertive Russia, is fuelling geopolitical tensions and creating potential flashpoints in areas such as the Middle East.

Increased political uncertainty tends to increase market volatility and create significant event risk. Therefore we think the value of effective portfolio risk management strategies is more important than ever.

Thanks Trevor. That wraps up this first episode of Fundamentals. We hope you enjoyed watching.

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