

Bonanza to Borrasca

Milan
24 - 25 February 2016

Kepler Cheuvreux

Local insight, European scale

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Managing Director

Head of Economics & Strategy Research

PART ONE

The Investment Year of 2016

January - February

Equity Make-or-Break

Test of Bear Market
Frontier

Exhaustion of \$-
Commodity Shock

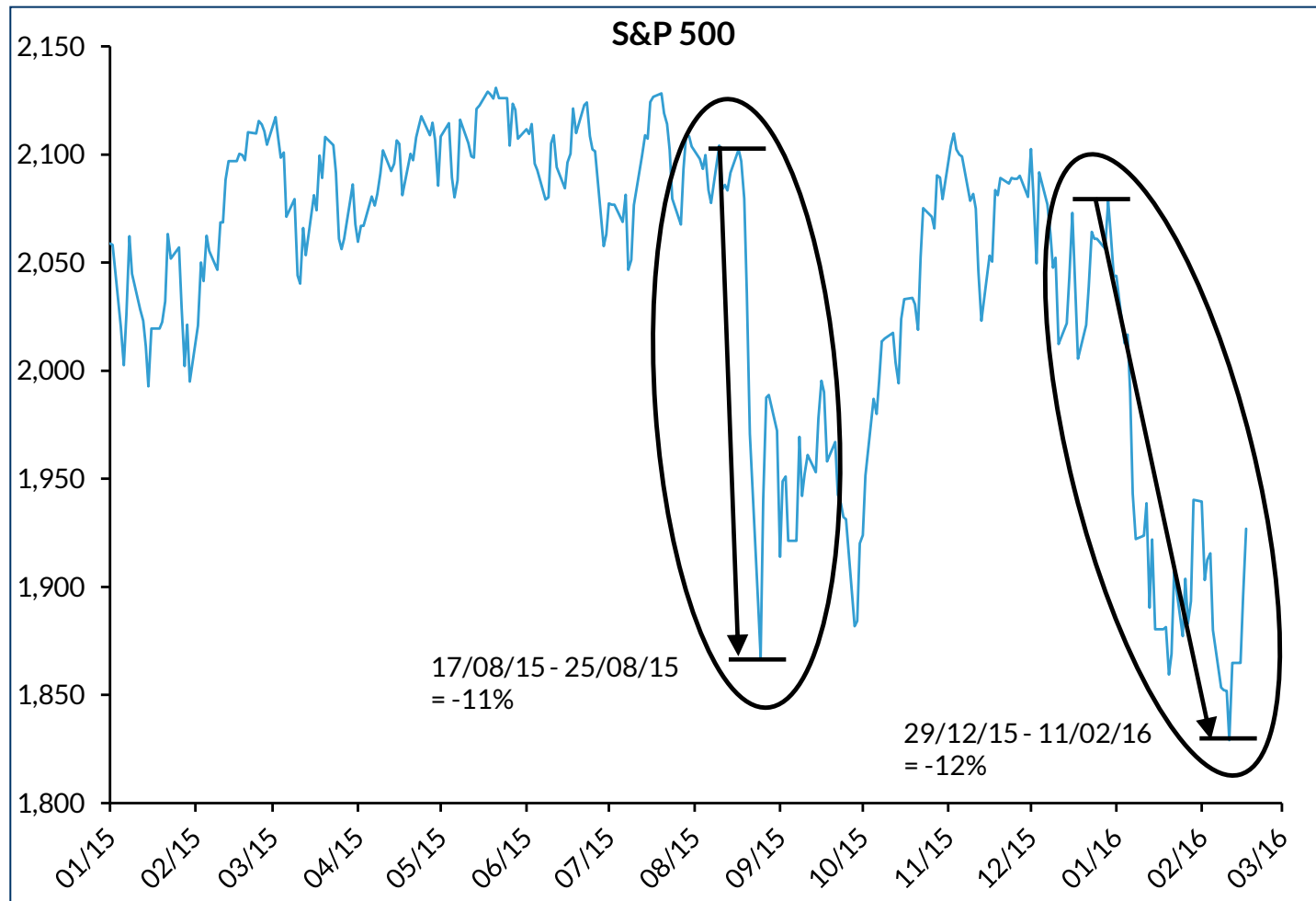
March - June

Portfolio Rotation as
Value bounces

2nd Half

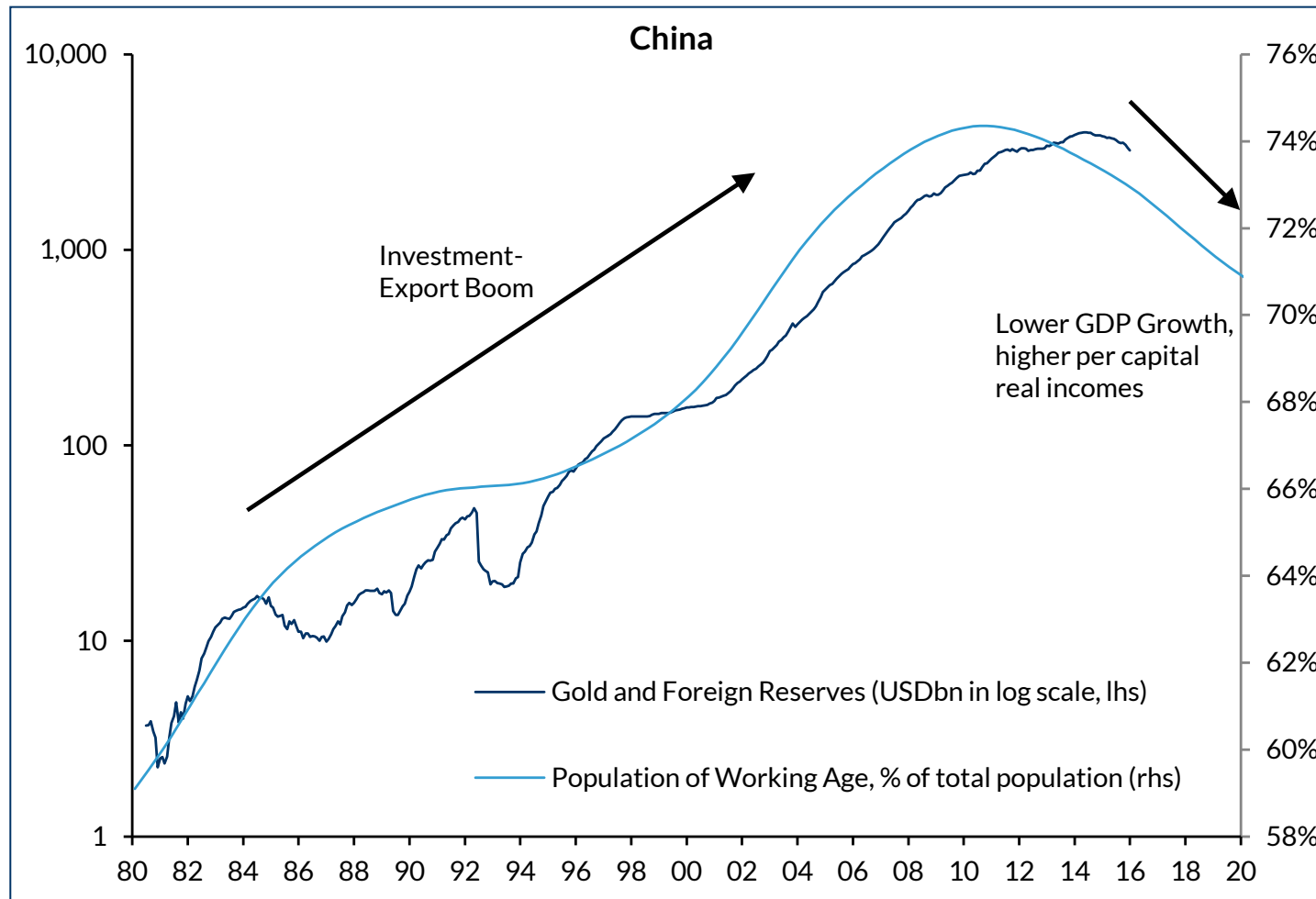
Return to Growth
- but domestic/regional
growth

The Frontier on the S&P 500 Index



Source: Datastream, Kepler Cheuvreux

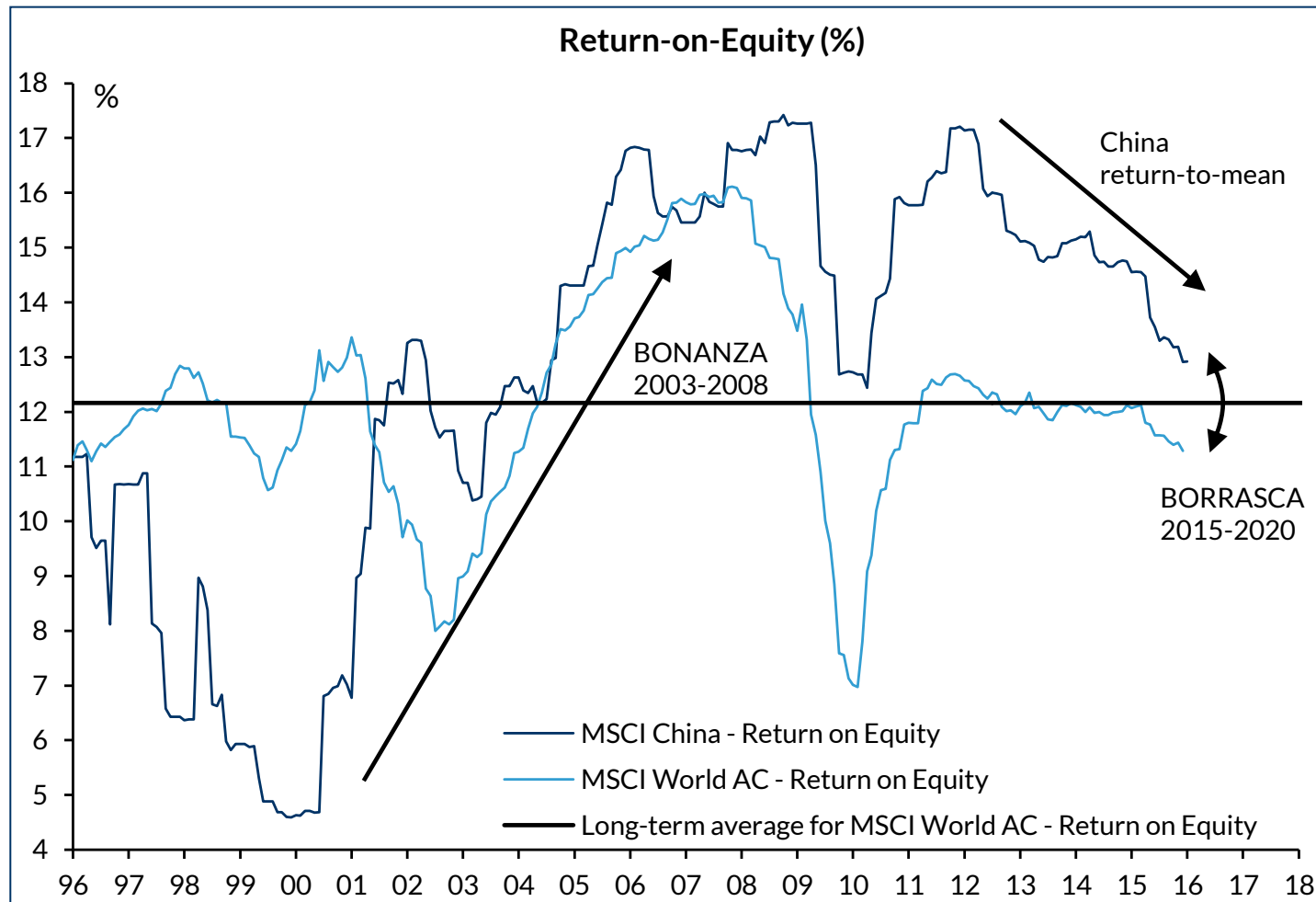
The China Transition (following the Asian precedent)



Source: The People's Bank of China, Oxford Economics, Datastream, Kepler Cheuvreux

Population of Working Age = estimates from Q1-2015

The End of the China Bonanza



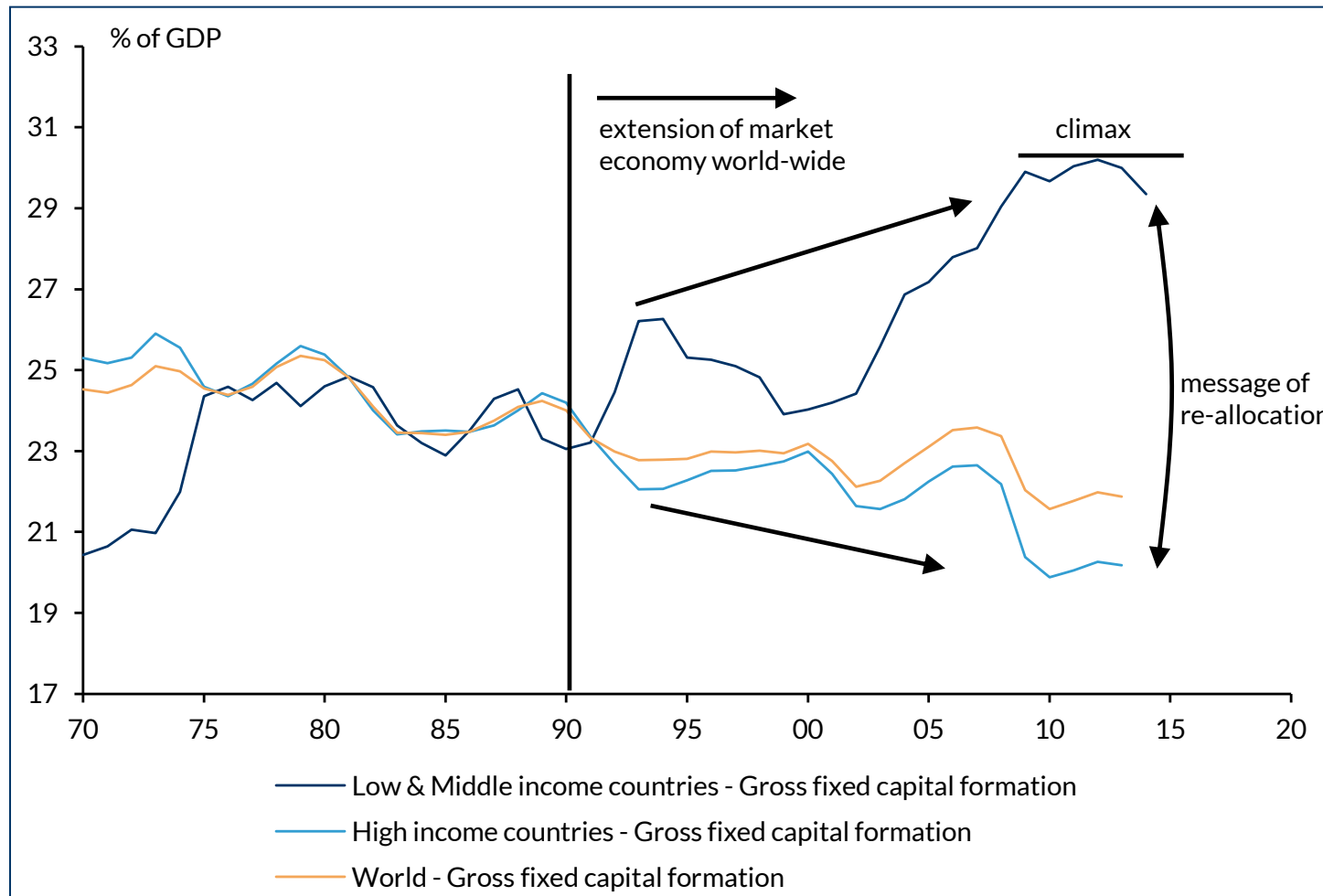
Source: Datastream, Kepler Cheuvreux

The Growth and Profitability Regime

The end of the boom of Global Growth implies lower investment and lower corporate profitability world-wide.

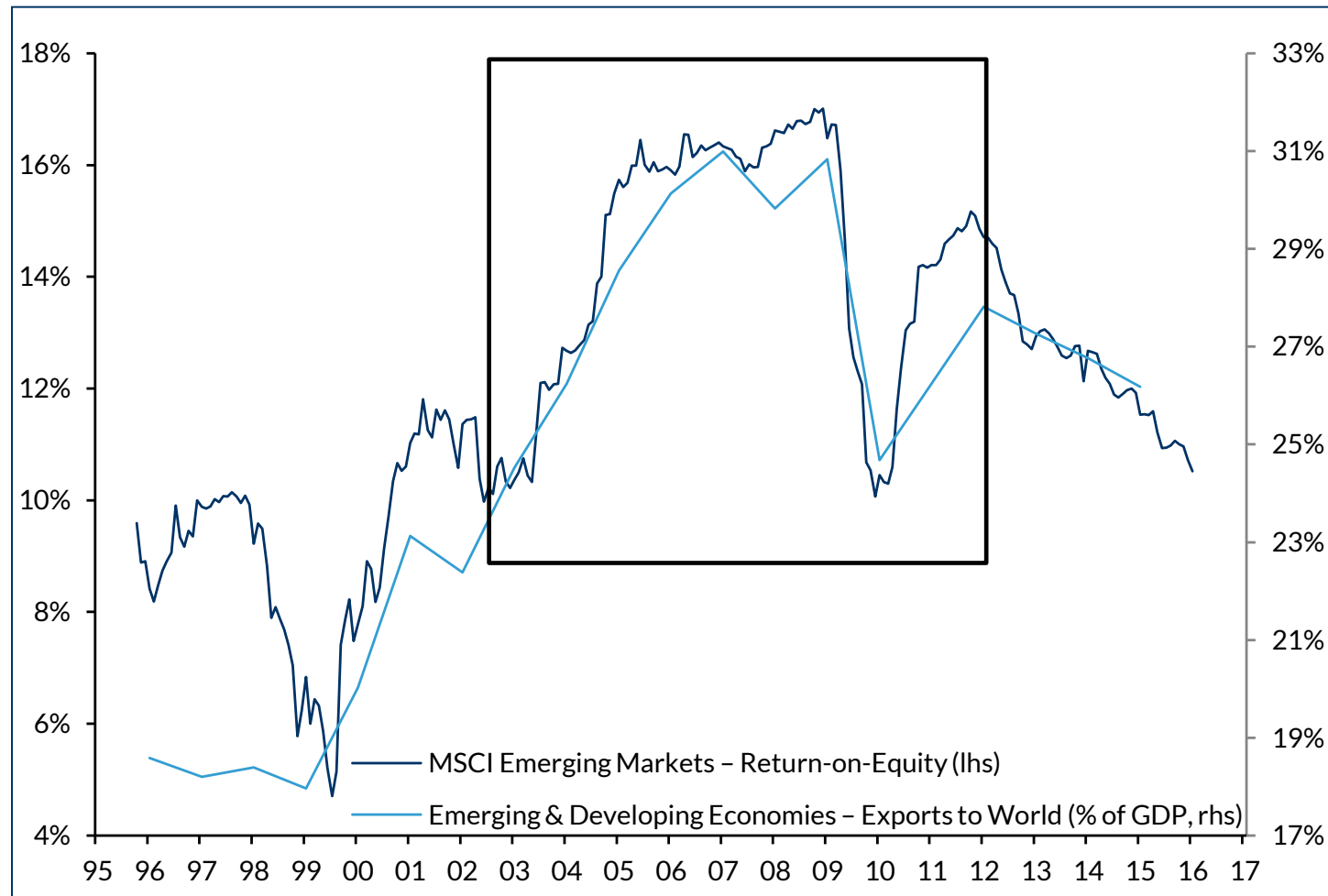
- **The incipient de-rating of global growth:**
 - ✓ The legacy of over investment through the producer decade is over-capacity and declining profitability in global product markets (the new deflation).
 - ✓ The world economy is no longer opening. A lower trade multiplier with China rebalancing and a resentful Russia.
 - ✓ Political resistance to globalisation has increased in tandem with the perception of rising inequalities.
 - ✓ Global re-balancing and reshoring: Europe following the American example
 - ✓ Profitability return-to-mean in China is not yet complete. China has become the object of suspicion among investors. Despite a degree of cyclical recovery in 2016 investor confidence in China will not be restored.
- **Increasing difficulties of the beneficiaries of global growth ---**
 - ✓ --- drives the resurgence of the relative valuation of domestic-regional growth plays in developed equity markets.
 - ✓ However, the improvement of the profitability of domestic-regional growth is insufficient to offset the fall in the excess profits associated with the global growth theme.
 - ✓ The decline in the profit content of world growth through this cycle reflects the fall in the high investment ratios associated with the boom of “globalisation” since the end of the 1980s.
 - ✓ The environment is becoming more favourable for labour in the developed economies. The services/employment content of growth is increasing. The labour share of incomes in the leading economies is beginning to recover.

The Global Investment Boom in Areas of Low-Cost Production



Last data = Low & Middle income countries → 2014; High income countries → 2013; World - Gross fixed capital formation → 2013

Emerging Markets: Return-on-Equity and Exports to the World

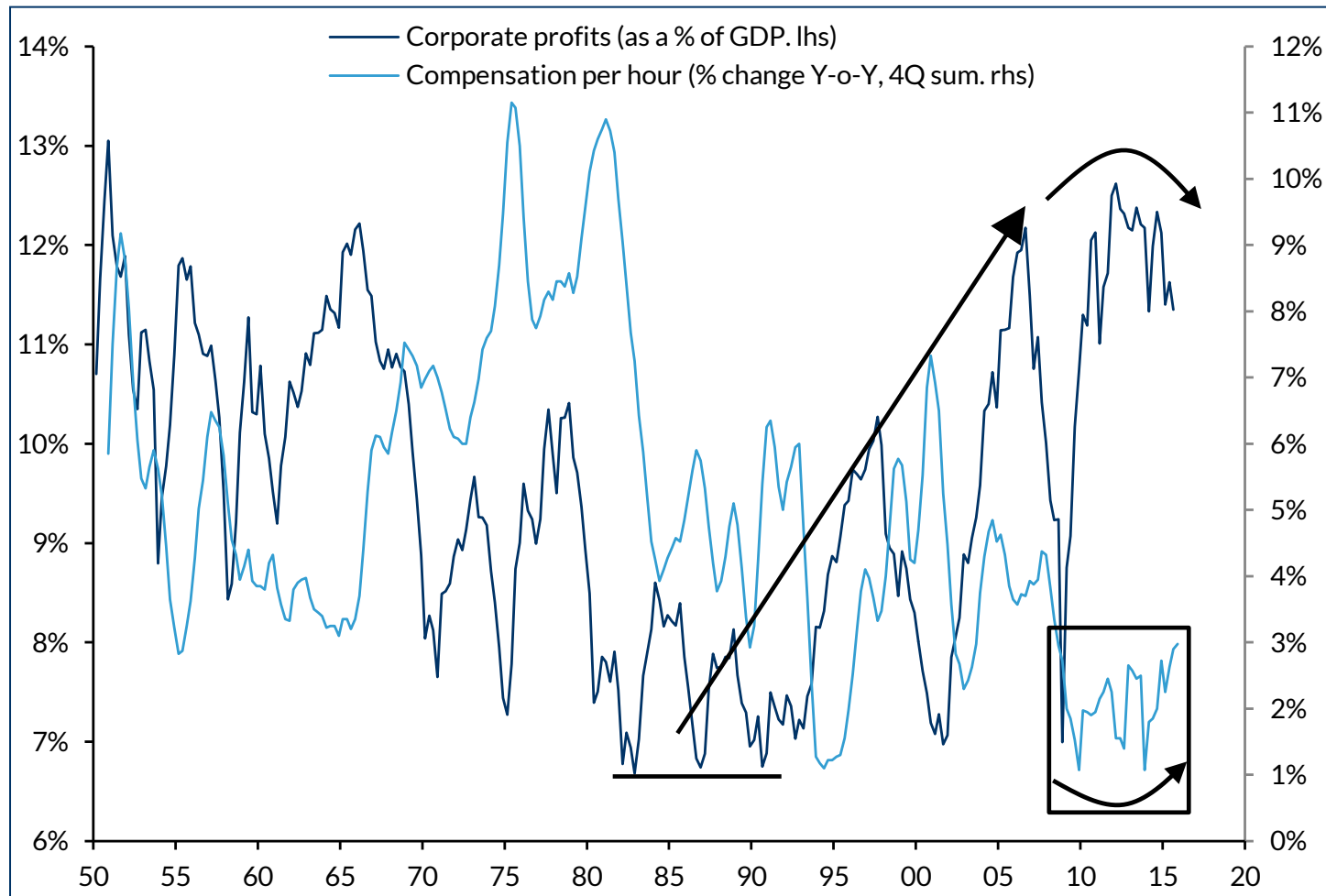


Source: IMF, Datastream, Kepler Cheuvreux

Last data:

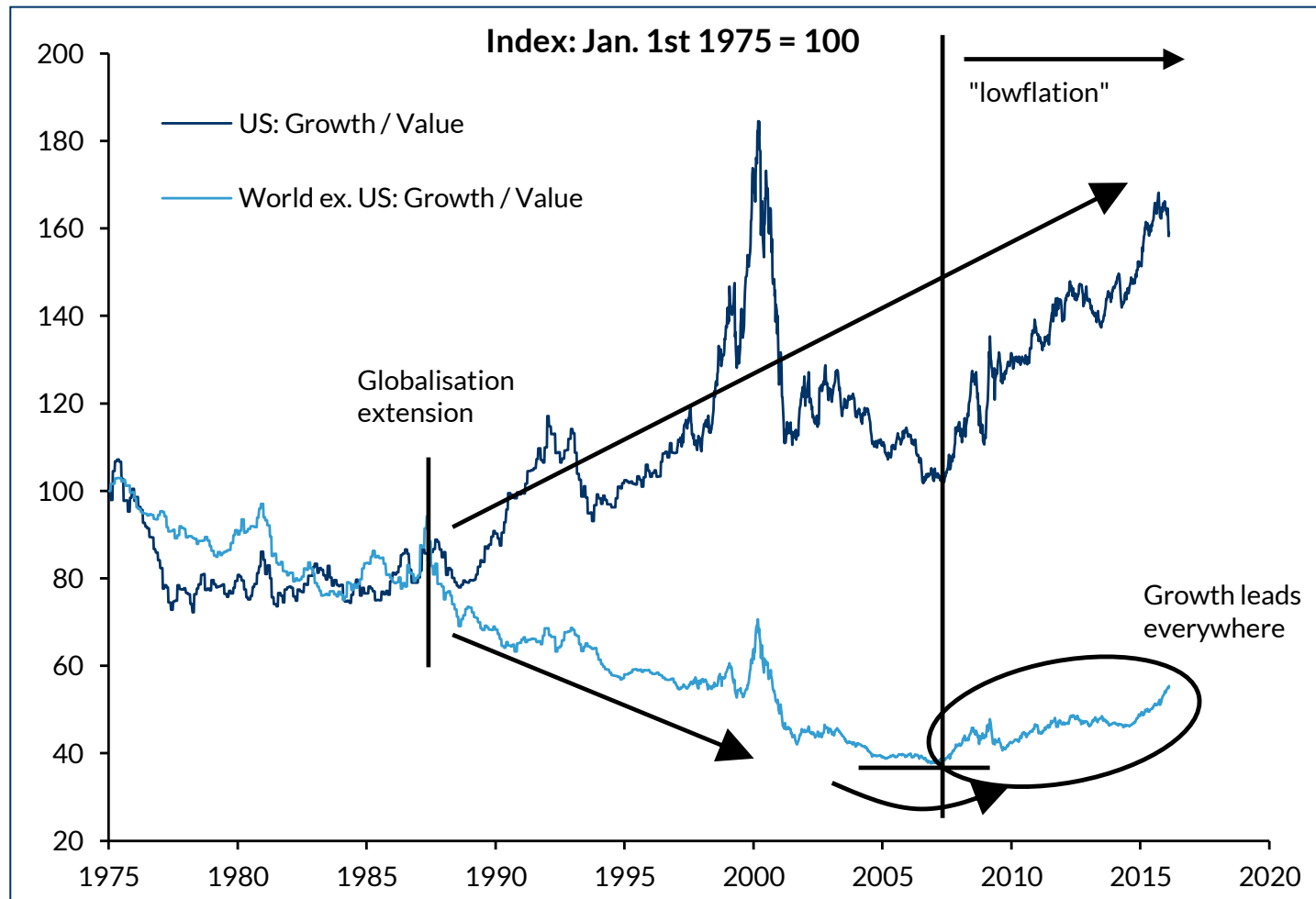
- MSCI Emerging Markets - Return-on-Equity = January 2016 (monthly data)
- Emerging & Developing Economies - Exports to World as a % of GDP = 2014 (annual data)

US Labour and Profit Share



Source: Bureau of Economic Analysis, U.S. Department of Commerce, Bureau of Labor Statistics, Datastream, Kepler Cheuvreux

Growth versus Value in the USA and the World ex. USA



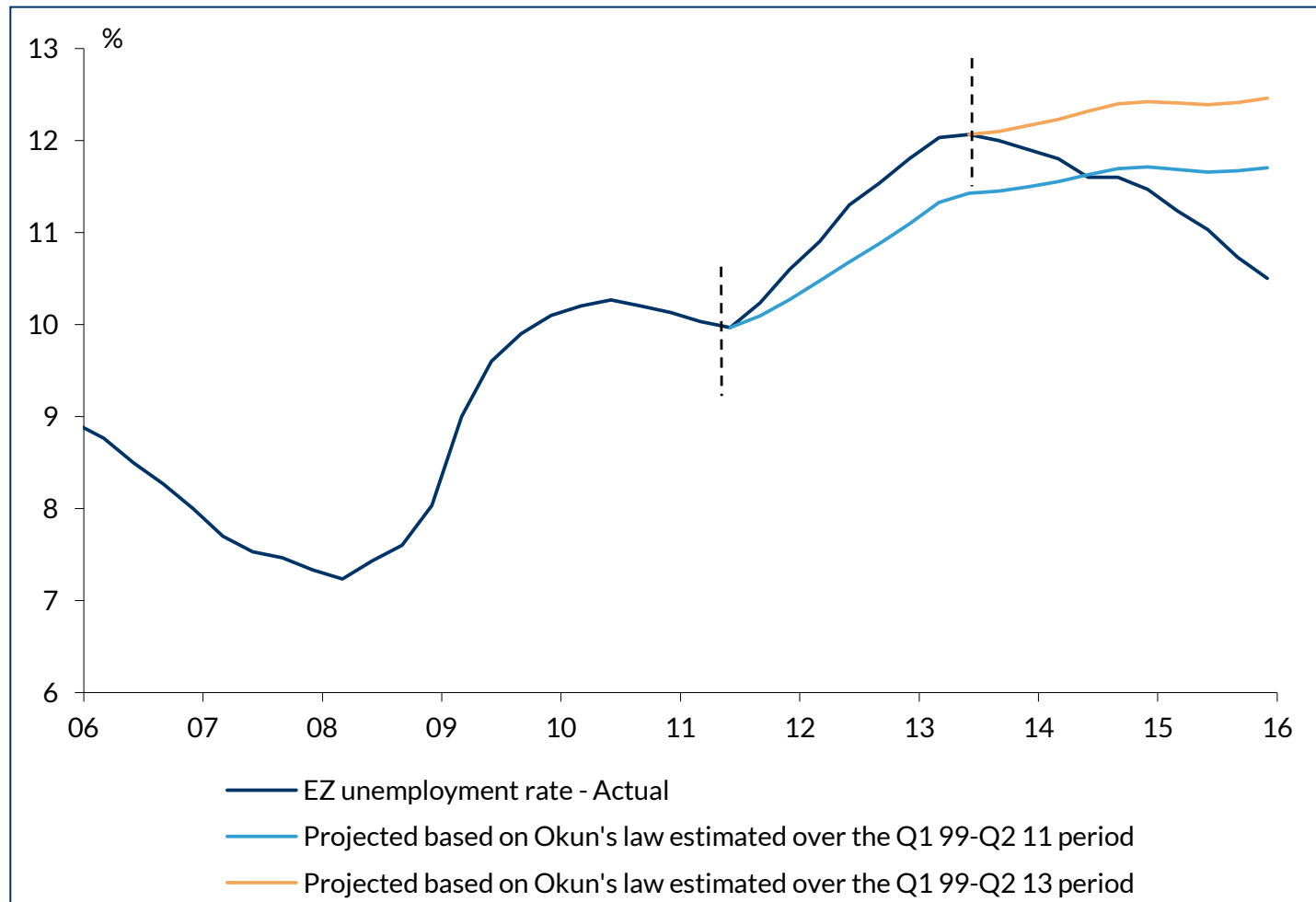
Source: Datastream, Kepler Cheuvreux

The Characteristic Structural Shifts of the Consumer Decade 2010-2020

	Falling	Rising
Content of Growth	Investment External Trade Profitability	Consumption Services Employment / Labour Remuneration

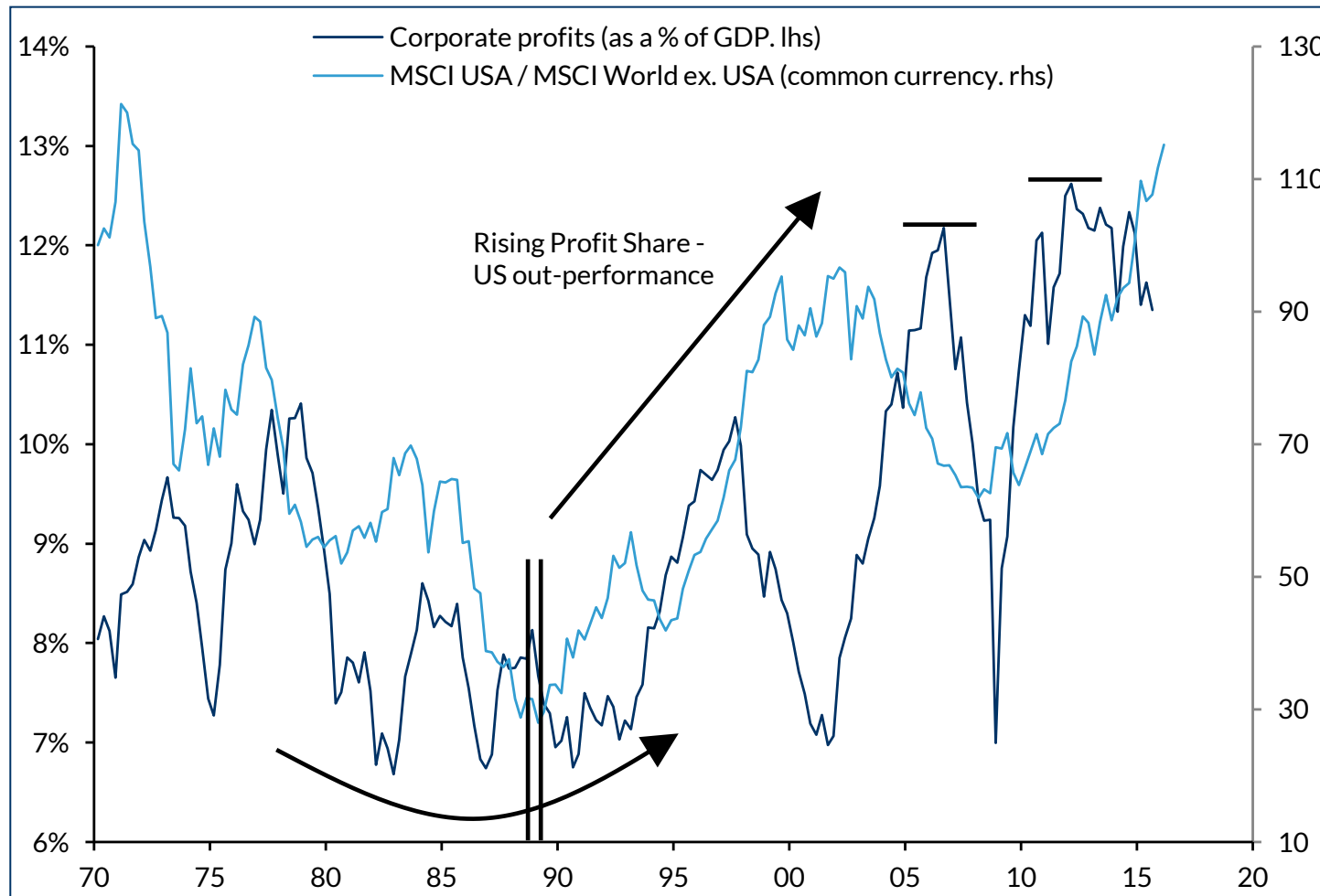
Source: Kepler Cheuvreux

EZ Unemployment : Growth with a higher Employment Content



Source: Datastream, Kepler Cheuvreux

Globalisation, the Profit Share and American Out-Performance



Source: Bureau of Economic Analysis, U.S. Department of Commerce Datastream, Kepler Cheuvreux

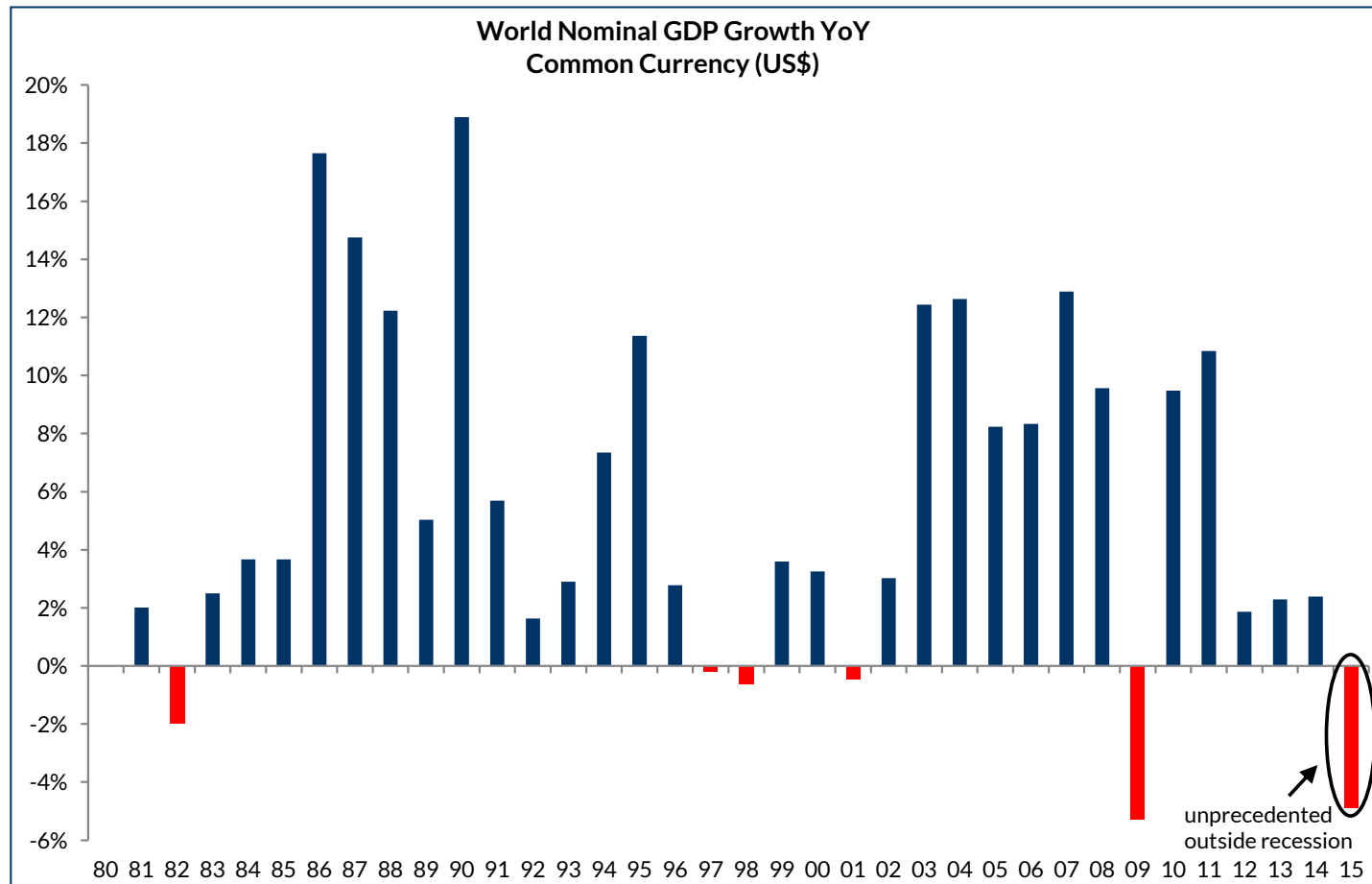
PART TWO

Cycles of \$ Strength-Commodity Decline since the 1970s



Source: Datastream, Kepler Cheuvreux

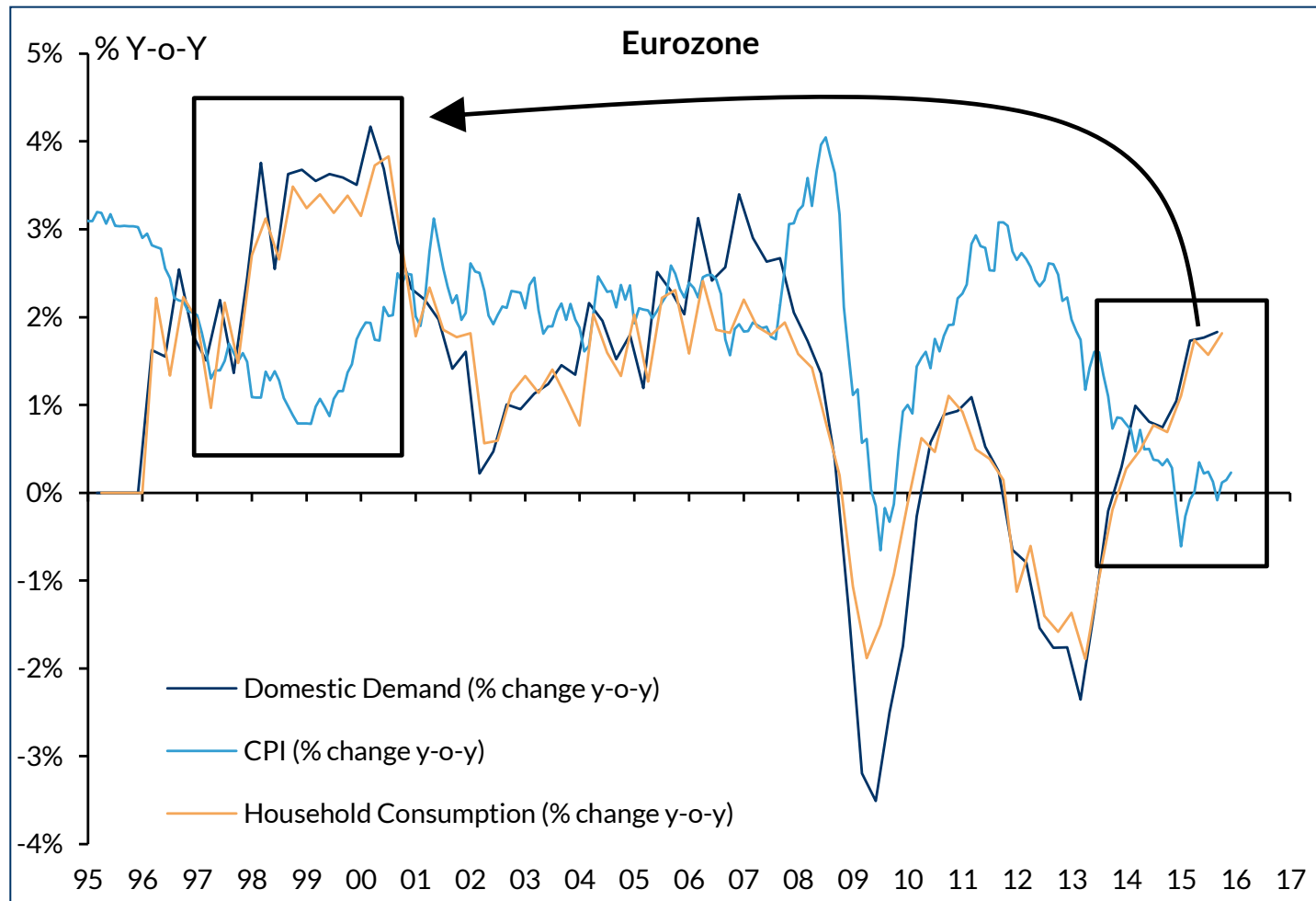
The Growth of World Nominal GDP in US\$ Terms



Source: IMF - World Economic Outlook, Datastream, Kepler Cheuvreux

IMF forecast for 2015

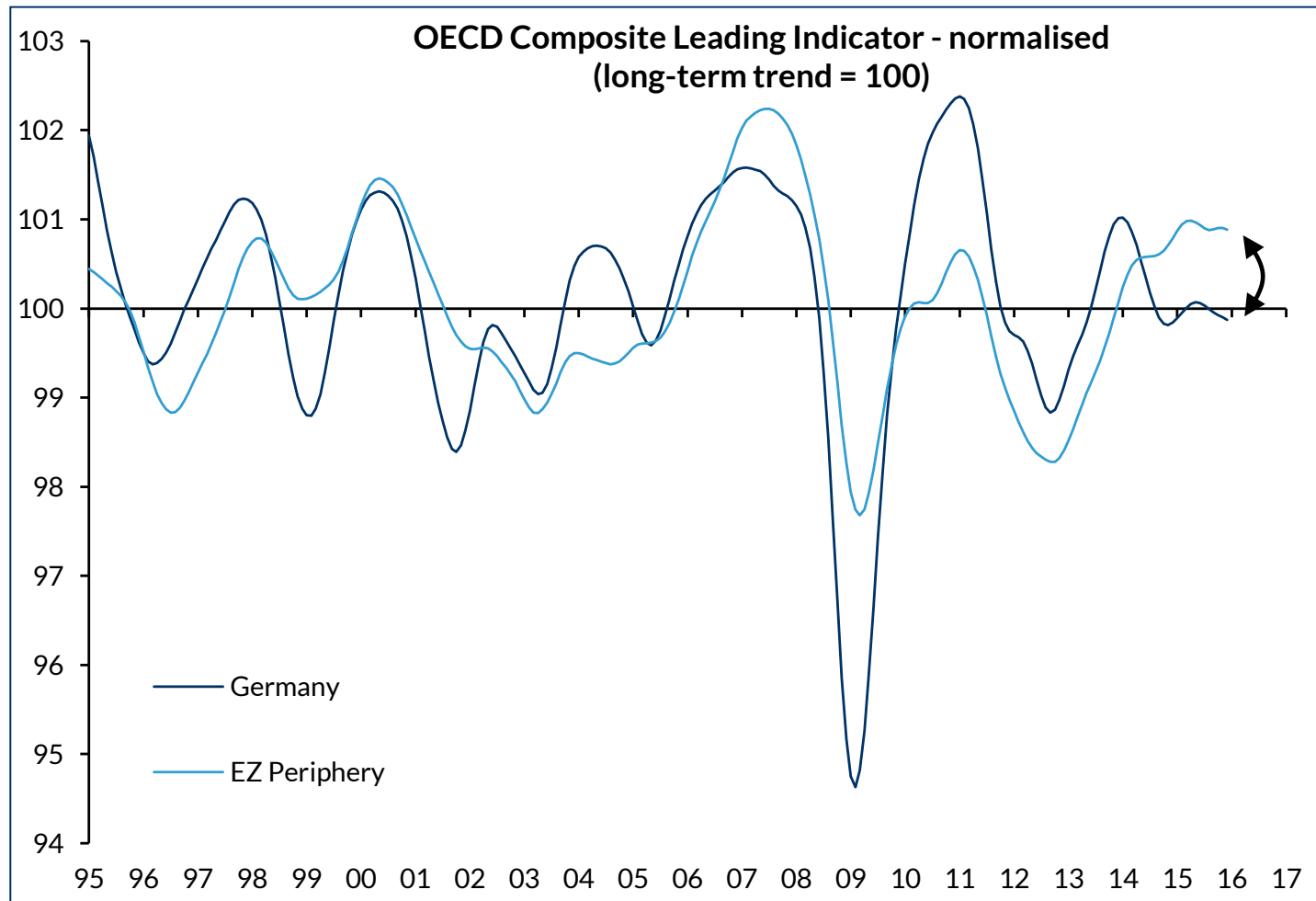
Domestic Demand, Household Consumption and Inflation in the EZ



Source: Datastream, Kepler Cheuvreux

Domestic Demand = Defined as the sum of final consumption and investment by the private and general government sectors.

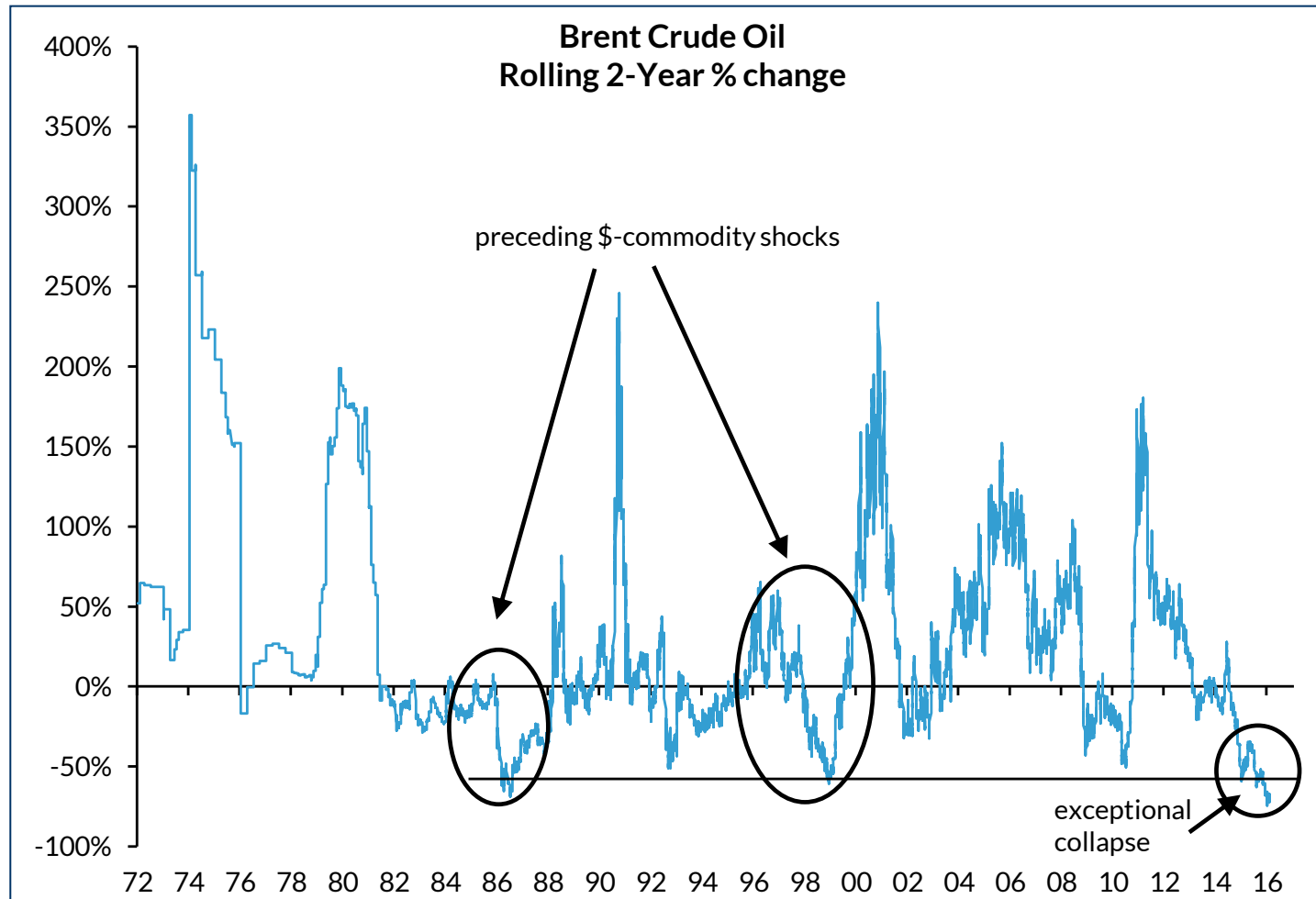
The Assymmetric Economic Effects of the \$-Commodity Shock within Europe



EZ Periphery = Greece, Ireland, Italy, Portugal, Spain (equal-weighted average)

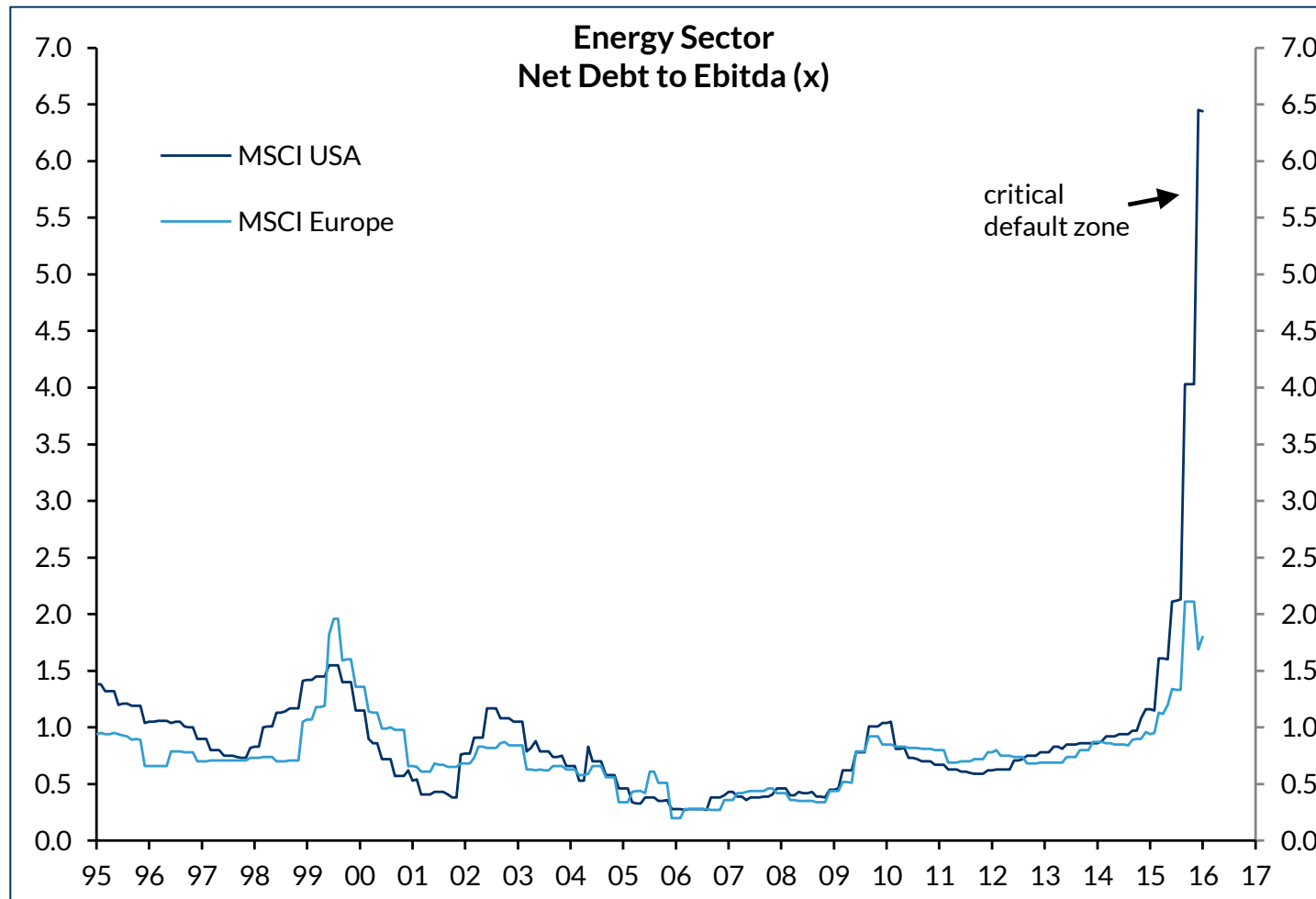
The **OECD Composite Leading Indicator (CLI)** is designed to provide early signals of turning points in business cycles – fluctuations of economic activity around its long term potential level.

The Exceptional Collapse of the Price of Crude Oil



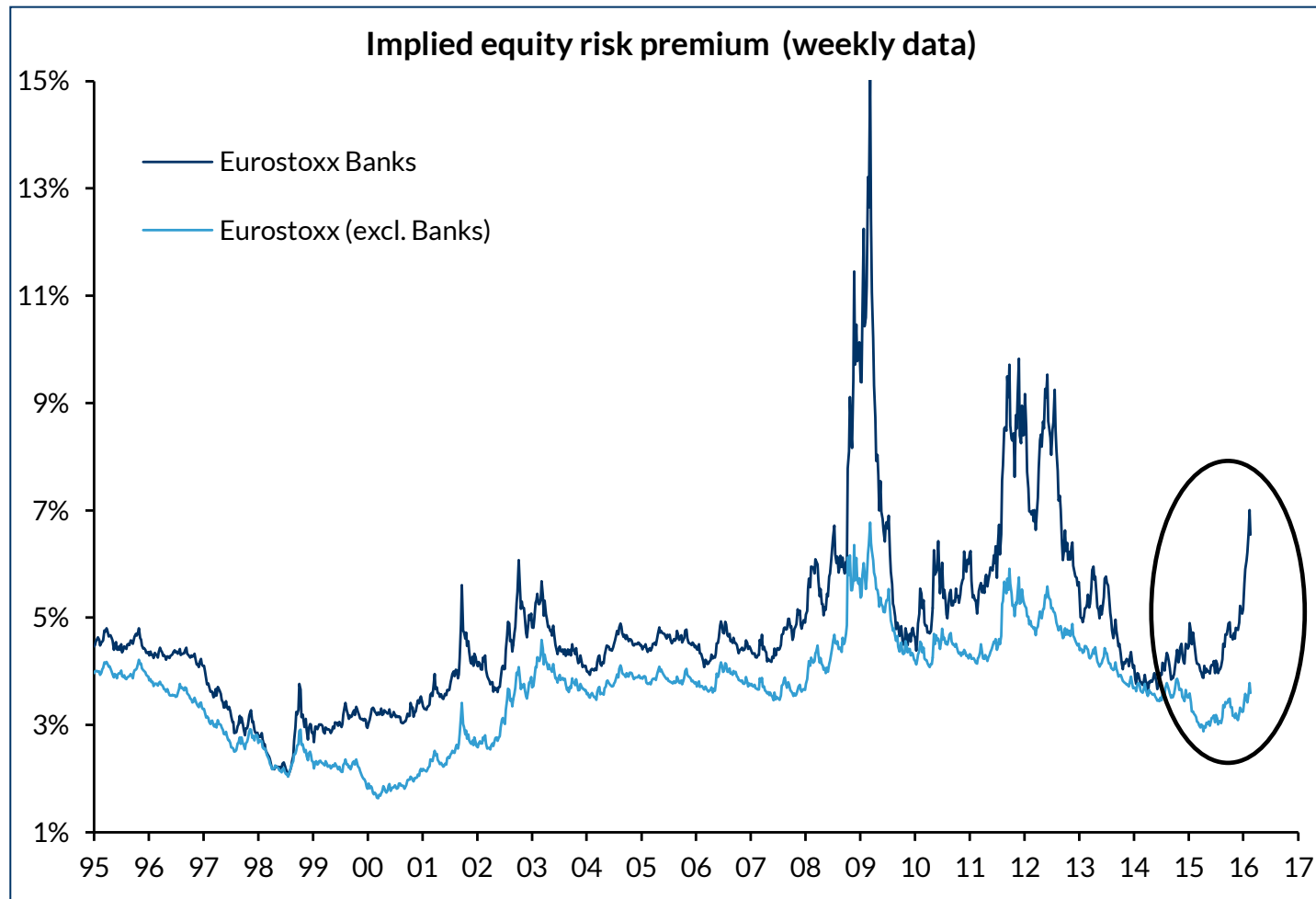
Source: Datastream, Kepler Cheuvreux

Net Debt to EBITDA for the Energy Sector in Europe and the US



Source: Bloomberg, Kepler Cheuvreux

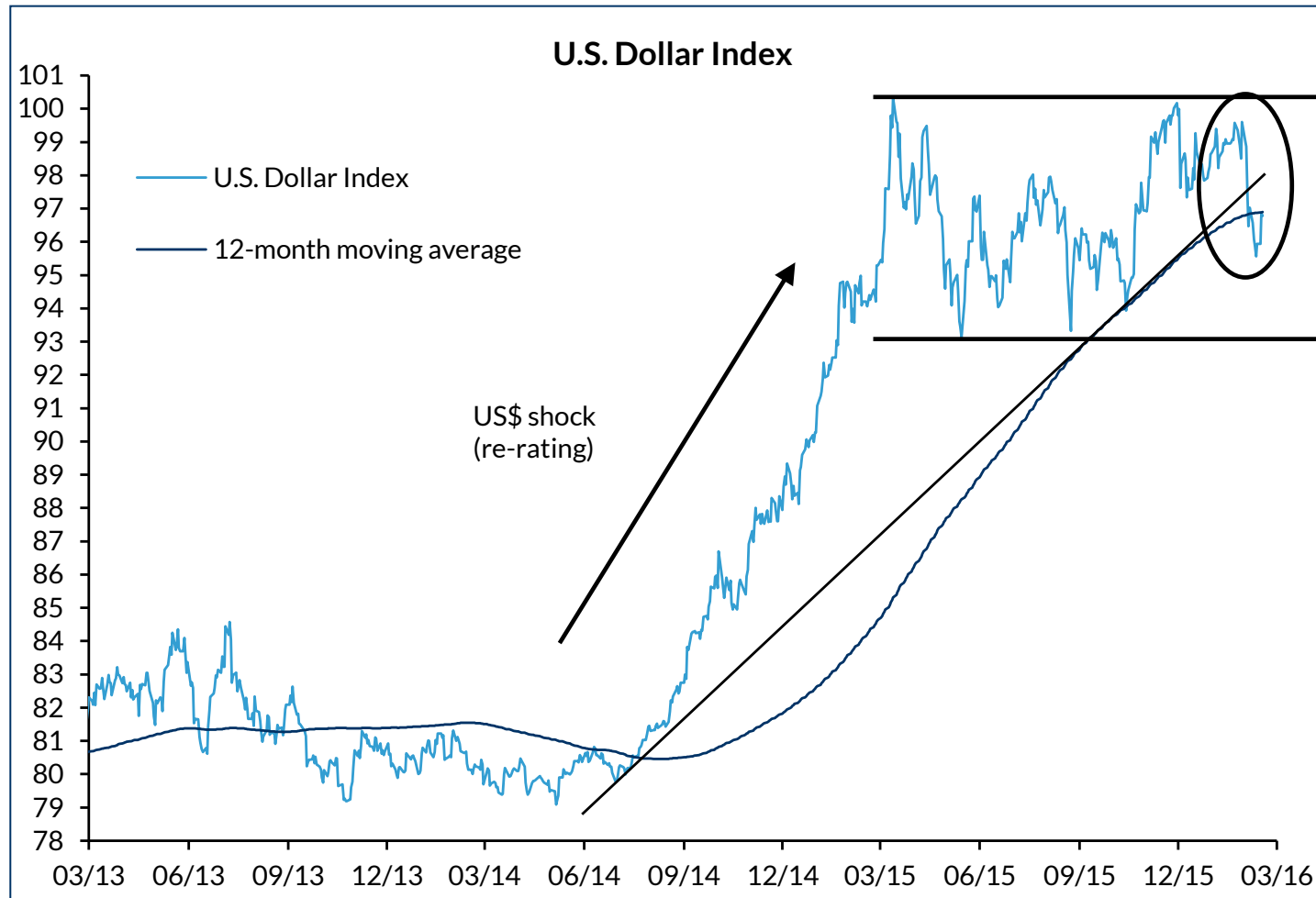
The Equity Risk Premium for Eurostoxx Banks and the Index ex. Banks



Source: FactSet, Kepler Cheuvreux

Implied Equity Risk Premium = 0.5x E/P where E/P is the inverse of the PER calculated with trend long-term, trend profits

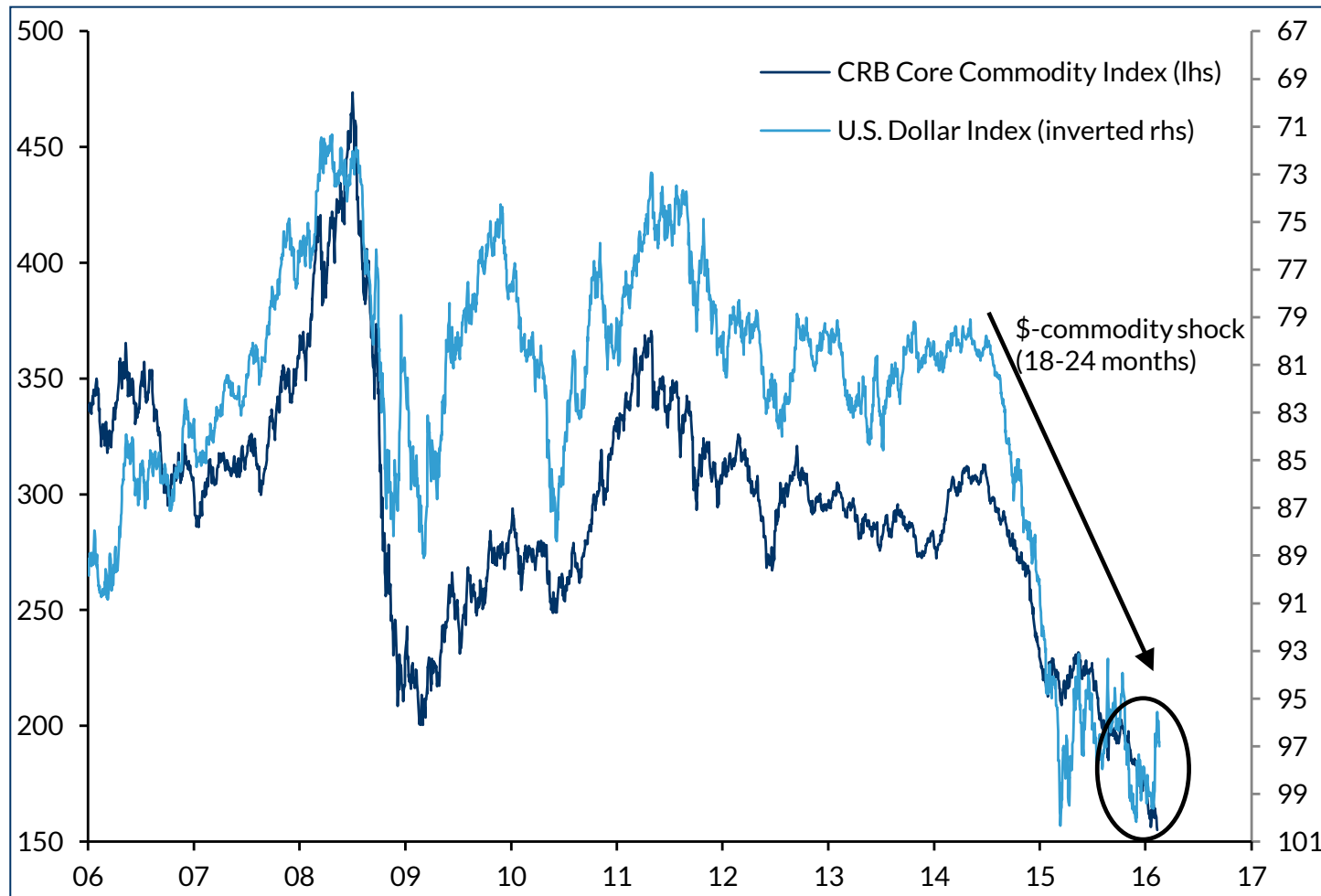
The U.S. Dollar Index



Source: Bloomberg, Kepler Cheuvreux

The **U.S. Dollar Index** indicates the general international value of the USD by averaging the exchange rates between the USD and major world currencies.

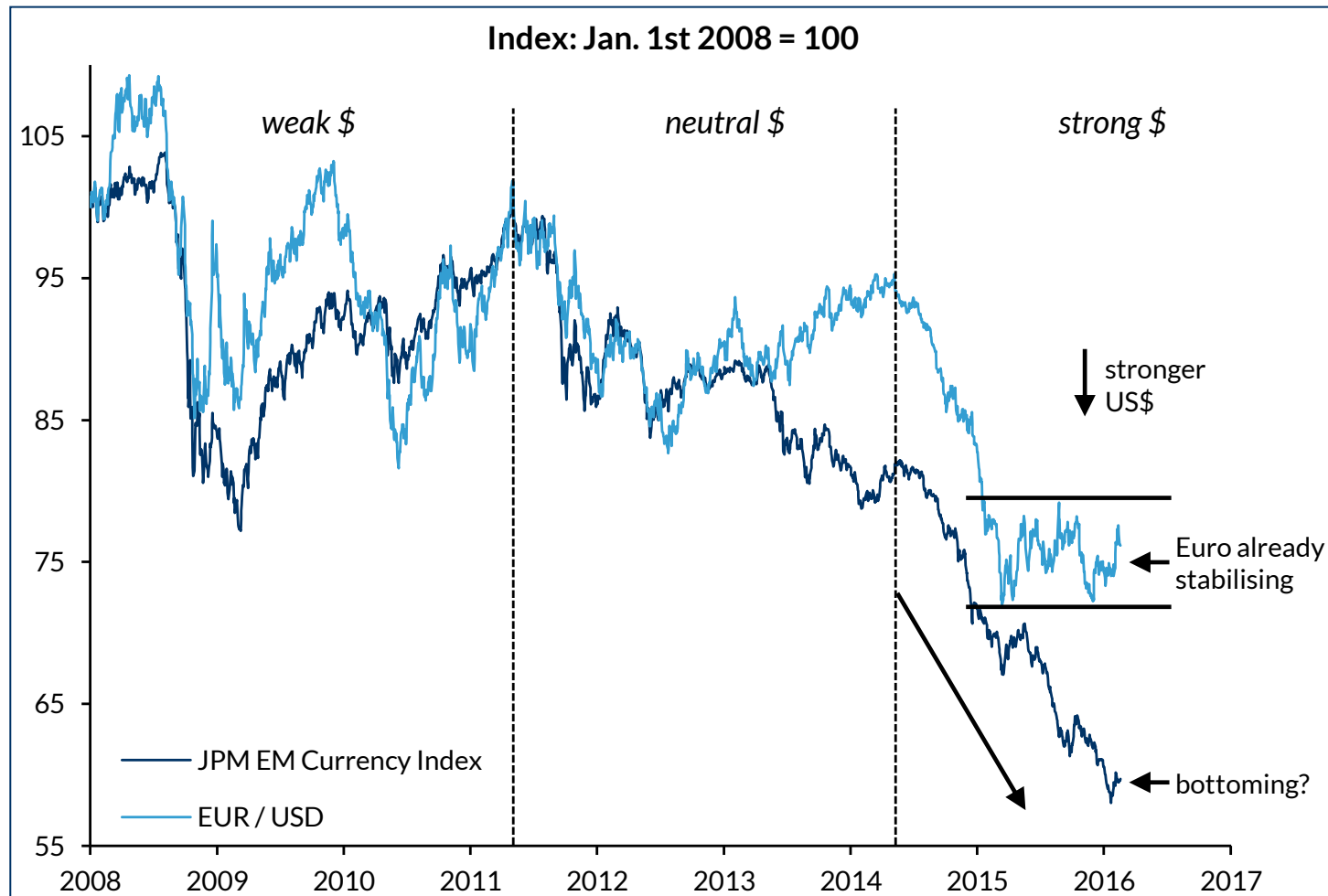
The U.S. Dollar Index and Commodity Values



Source: Thomson Reuters/CoreCommodity CRB, Bloomberg, Kepler Cheuvreux

The Thomson Reuters/Core Commodity CRB Total Return Index is an arithmetic average of commodity futures prices with monthly rebalancing. The index is comprised of 19 commodities.

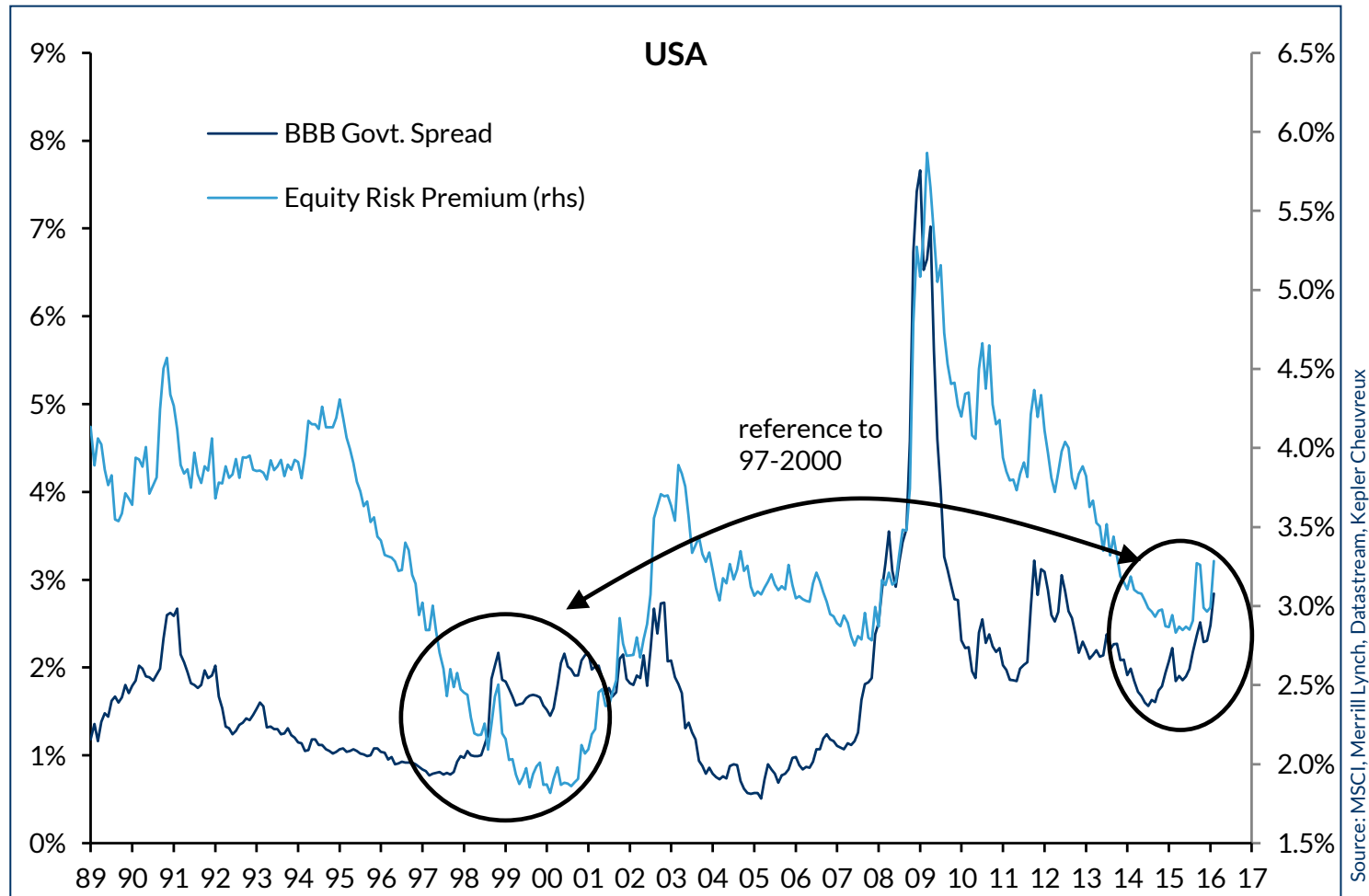
\$-Euro and the \$ against Emerging currencies



Source: J.P. Morgan Chase Bank, Bloomberg, Datastream, Kepler Cheuvreux

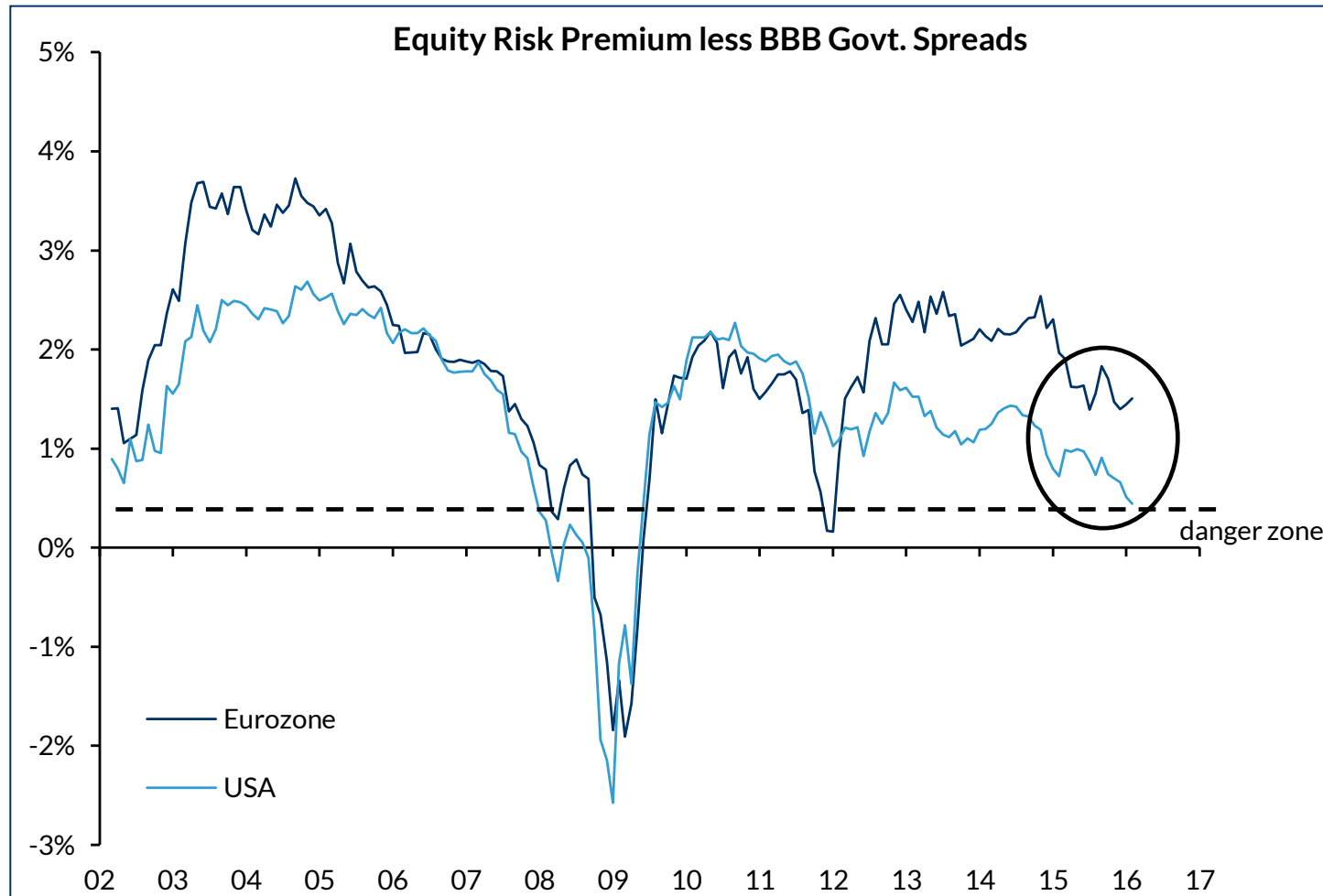
The J.P. Morgan EMCI index is a tradable benchmark for emerging markets currencies vs USD. The index comprises of 10 currencies: BRL, CLP, CNH, HUF, INR, MXN, RUB, SGD, TRY, ZAR

BBB Credit Spreads and the Equity Risk Premium in the USA



BBB Govt Spread = Yield Spread between the U.S. 7-10Y Corporate BBB Bond Index and the U.S. 7-10Y Treasury Bond Index.
Equity Risk Premium = $0.5 \times E/P$ where E/P is the inverse of the PER calculated with trend, long-term profits (using an HP filter).
 Calculated using the MSCI USA Index.

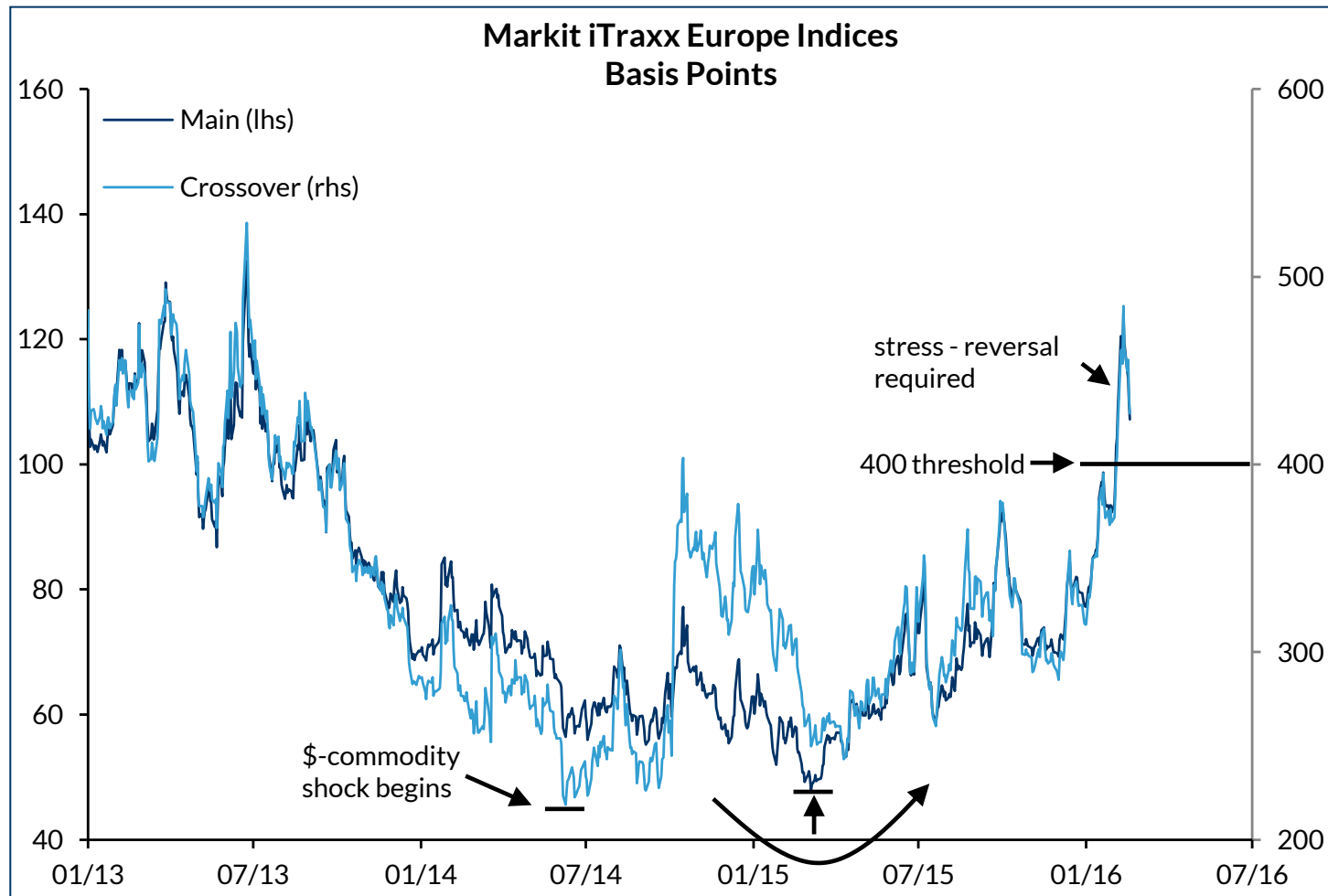
The Equity Risk Premium minus Credit Spreads in the USA and EZ



Source: MSCI, Merrill Lynch, Datastream, Kepler Cheuvreux

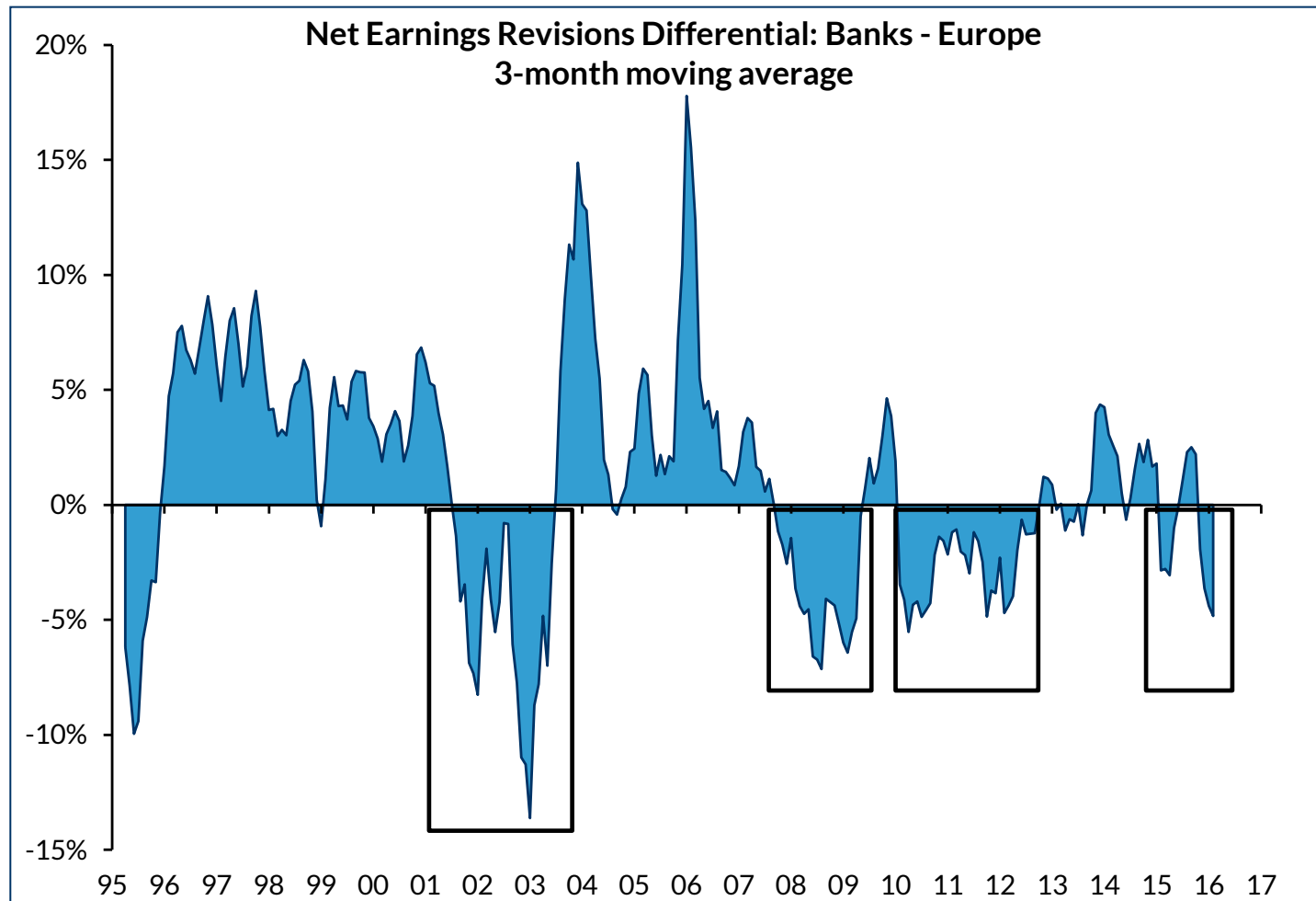
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Equity Risk Premium = $0.5 \times E/P$ where E/P is the inverse of the PER calculated with trend, long-term profits (using an HP filter).
 Calculated using the MSCI USA Index.

The European Credit Cycle: iTraxx Main and Crossover Indices



Source: Markit, Bloomberg, Kepler Cheuvreux

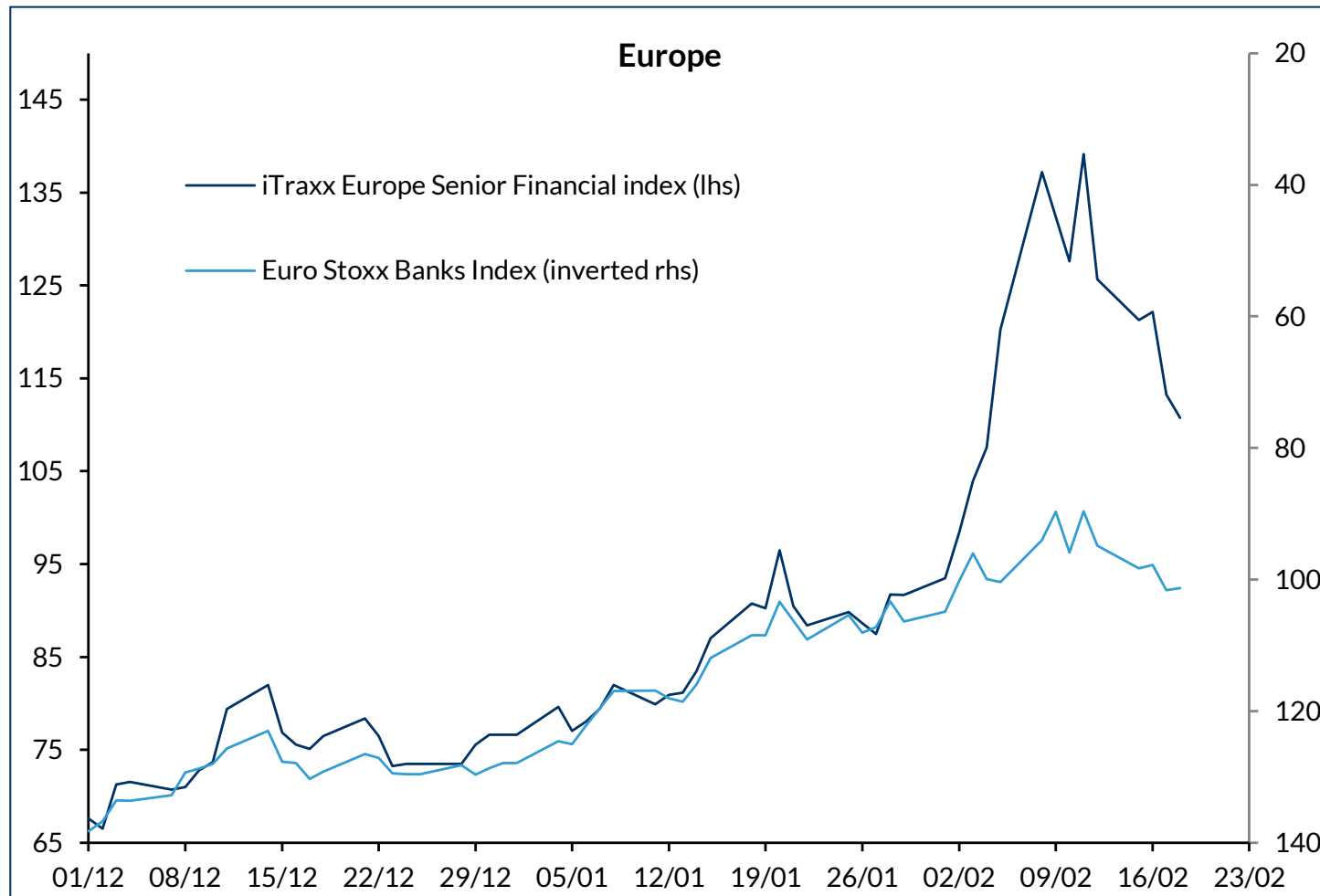
Net Earnings Revisions Differential between Banks and All Europe



Source: Datastream, Kepler Cheuvreux

Net Earnings Revisions = the % of net earnings revisions made by brokers. It is measured as the difference between the number of upward and downward 12 month forward earnings estimates, divided by the total number of 12 month forward earnings estimates.

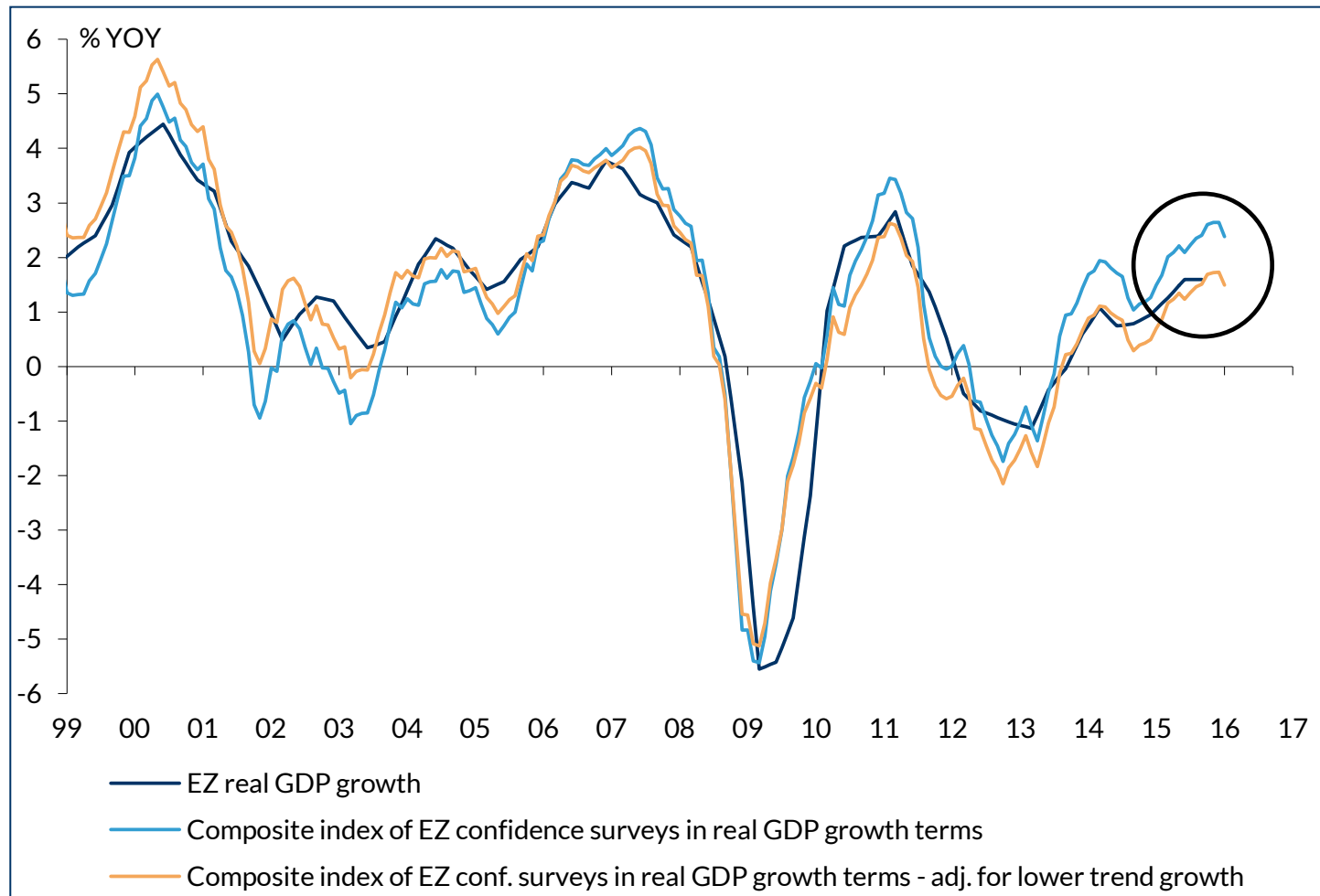
The Crisis in Europe's Credit-Banking Space



Source: Bloomberg, Kepler Cheuvreux

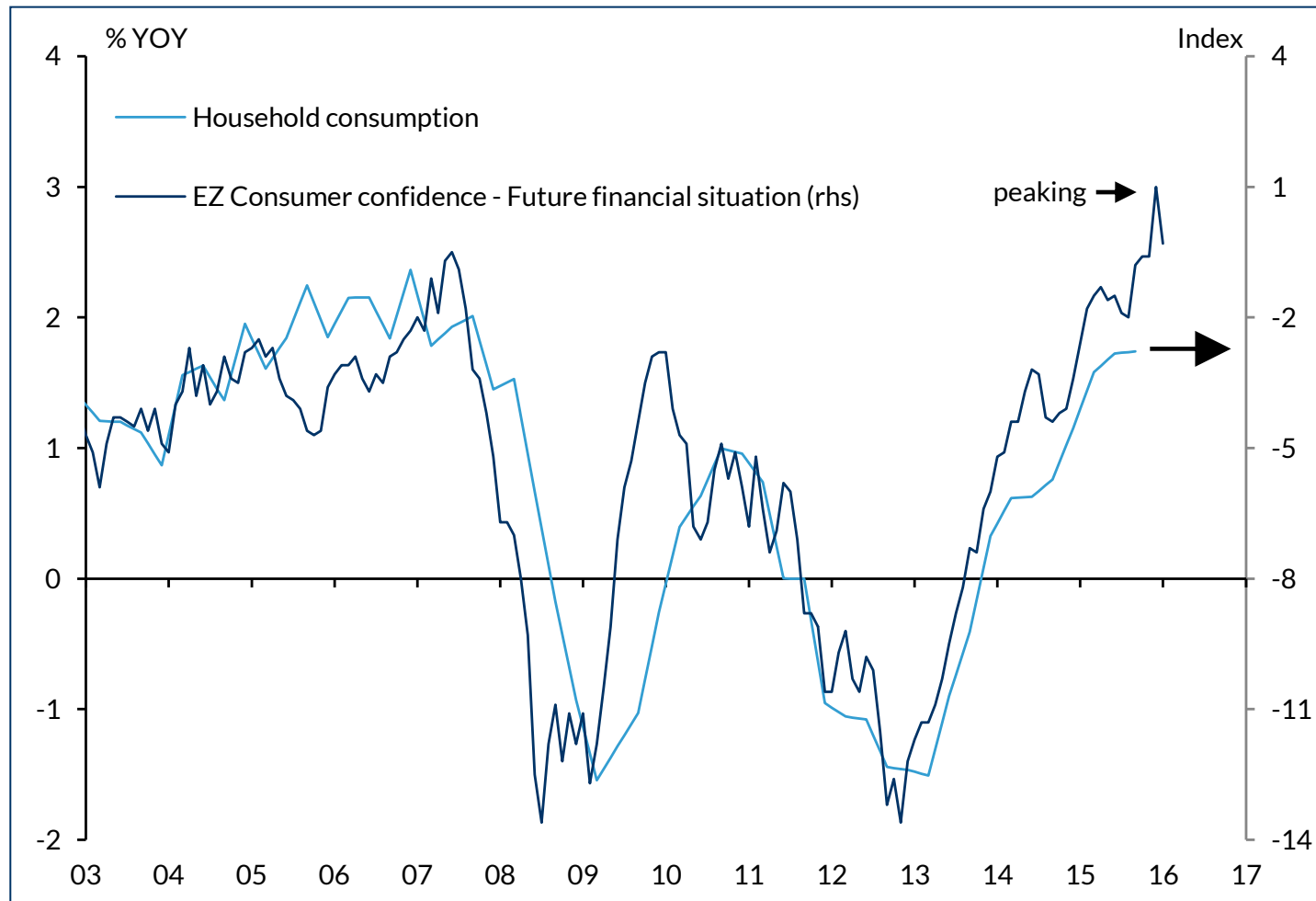
PART THREE

The Kepler-Cheuvreux Advanced Survey Indicator of EZ GDP Growth



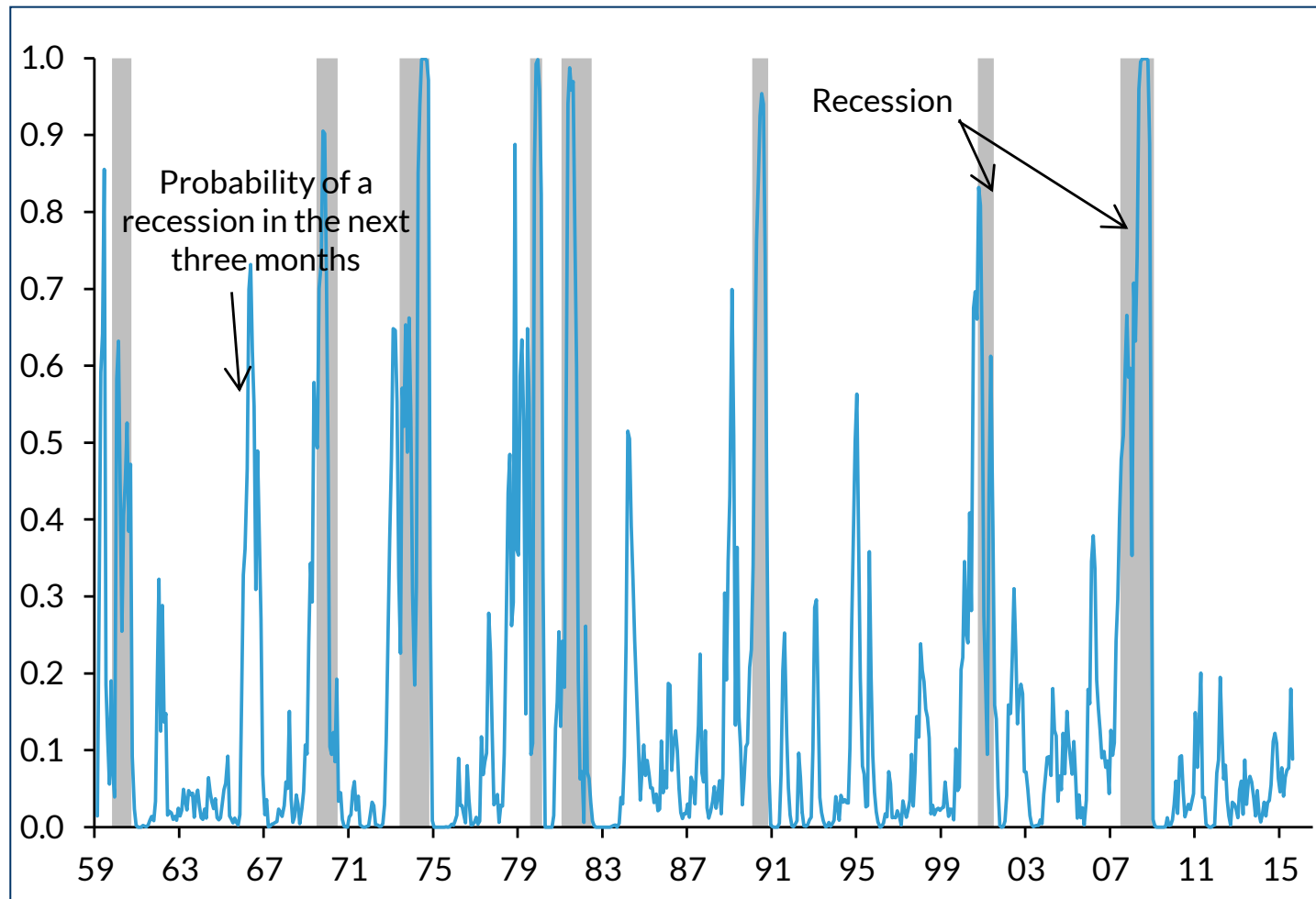
Source: Datastream, Kepler Cheuvreux

Consumer Confidence and Household Spending in the Eurozone



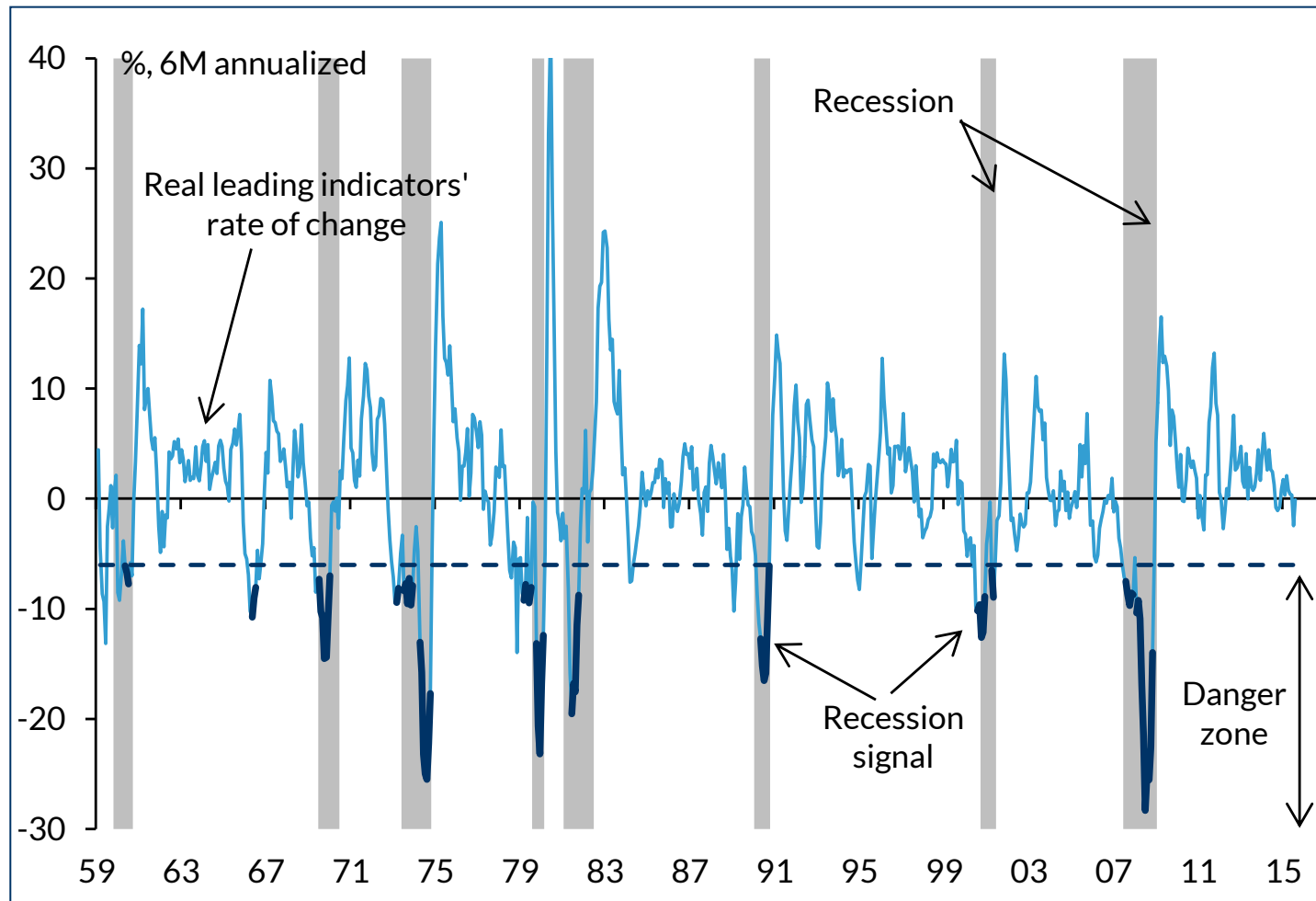
Source: Datastream, Kepler Cheuvreux

The Kepler-Cheuvreux Leading Indicator for the US Economy



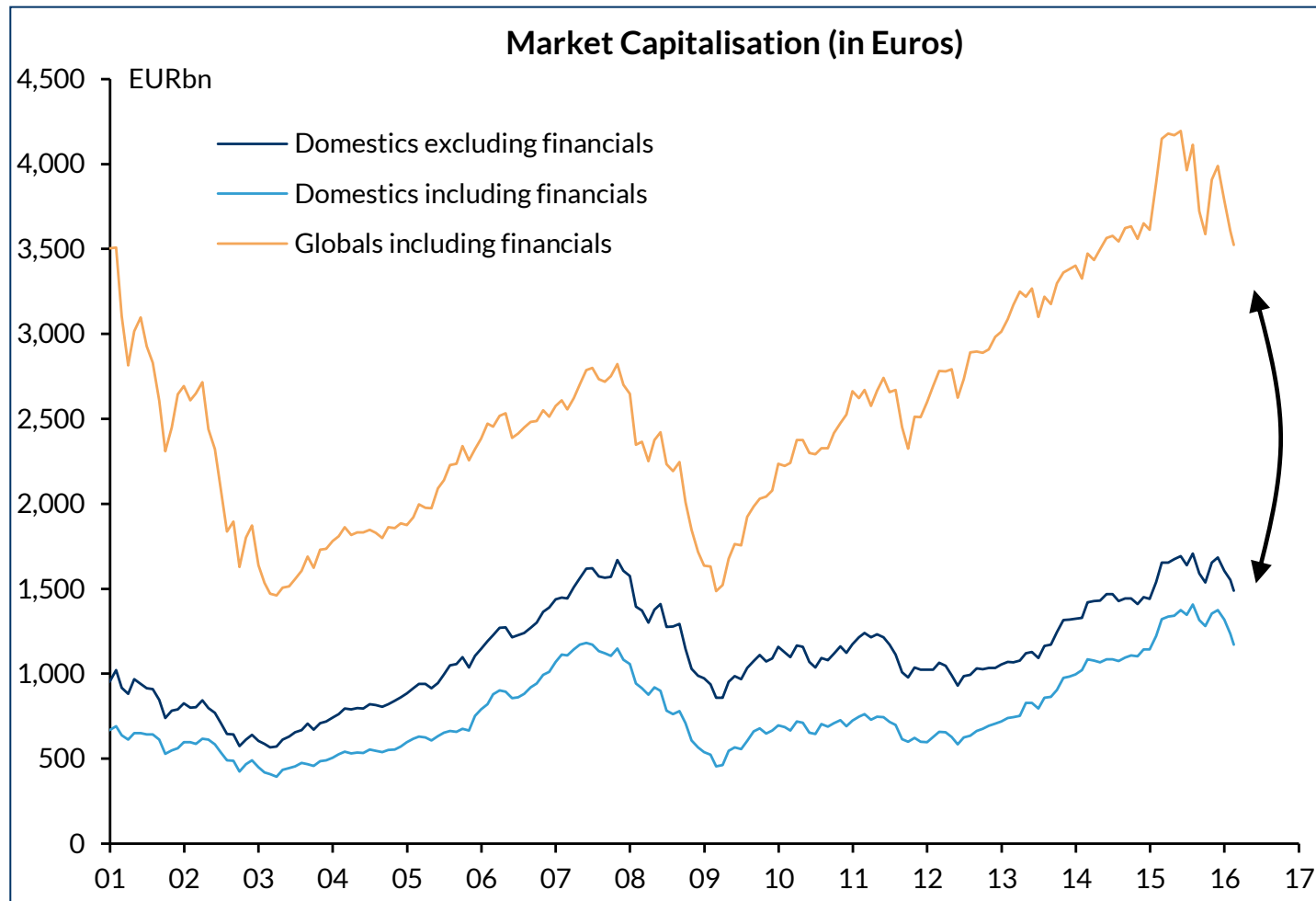
Source: Datastream, Kepler Cheuvreux

The Kepler-Cheuvreux Recession Probability Model based on our LEI



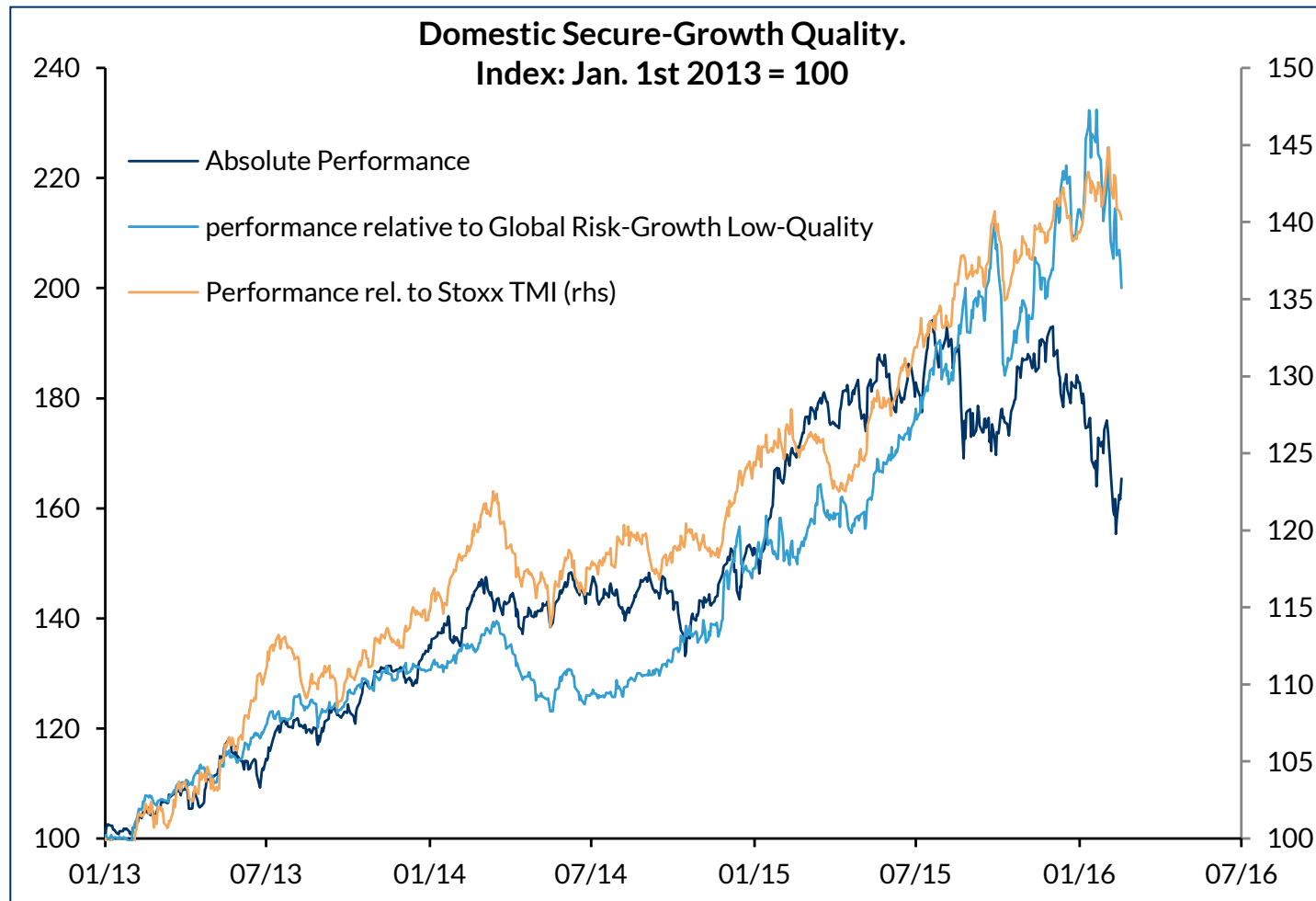
Source: Conference Board, Bloomberg, Kepler Cheuvreux

Domestics / Globals : Free-Float Market Capitalisation



Domestics = 150 stocks extracted from the Stoxx Europe 600 Index with the highest exposure to Western Europe (FY 2014)
Globals = 150 stocks extracted from the Stoxx Europe 600 Index with the lowest exposure to Western Europe (FY 2014)

The Leadership of Quality Domestic Growth in Europe



Domestic Secure-Growth Portfolio = Atea ASA, Atos SE, Axel Springer SE, Babcock International Group PLC, Bellway p.l.c., Bovis Homes Group PLC, Cap Gemini SA, Chocoladefabriken Lindt & Spruengli AG, Chocoladefabriken Lindt & Spruengli AG Partizipsch., Coloplast A/S Class B, CTS Eventim AG & Co. KGaA, D'Ieteren SA, De'Longhi S.p.A., Derwent London plc, Domino's Pizza Group plc, DSV A/S, Econocom Group SA Class D, Eiffage SA, Geberit AG, Glanbia Plc, Grafton Group Plc, Hamburger Hafen und Logistik AG, Iliad SA, Ipsen SA, Jcdecaux SA, Jeronimo Martins, SGPS S.A., Kingspan Group Plc, Leroy Seafood Group ASA, Meda AB Class A, Mobistar SA, N Brown Group plc, NEXITY Class A, Nobia AB, Orpea SA, Paragon Group of Companies PLC, Persimmon Plc, ProSiebenSat.1 Media SE, Restaurant Group plc, Rockwool International A/S Class B, Shanks Group plc, SIG plc, Telecty Group plc, Travis Perkins plc, Unibet GRoup Plc Shs Swedish Depository Receipts, Valiant Holding AG, Whitbread PLC, Wirecard AG

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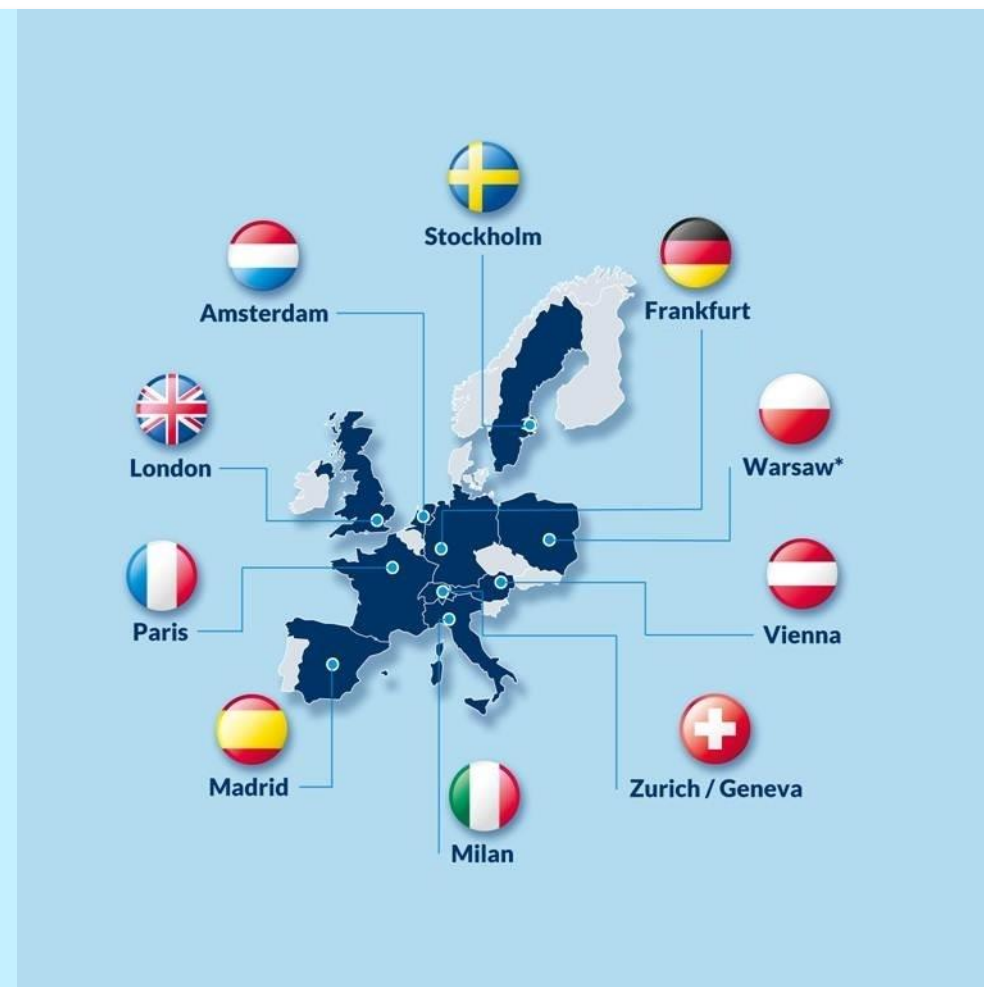
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