



## OUTLOOK 2015 – MACRO ECONOMY / EQUITIES / BONDS

28. November 2014



**Bart Van Craeynest**  
Chief Economist

**Maarten Geerdink**  
Chairman Asset Allocation Committee

# Outlook 2015

## → Economic outlook 2015

- ▶ Bart Van Craeynest – Chief Economist

## → Global asset class outlook 2015

- ▶ Maarten Geerdink – Chairman Asset Allocation Committee

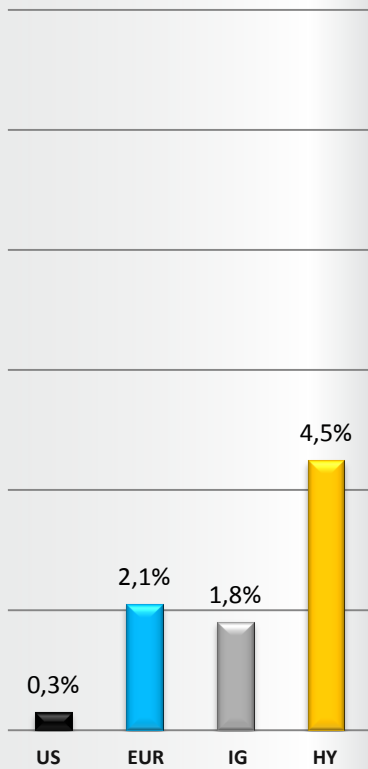
# 2014 Outlook

- Activity: global recovery remains on track
- Inflation: remains firmly under control
- Policy: US moving to less easing, but overall monetary stance remains very supportive
- Fed key for financial markets

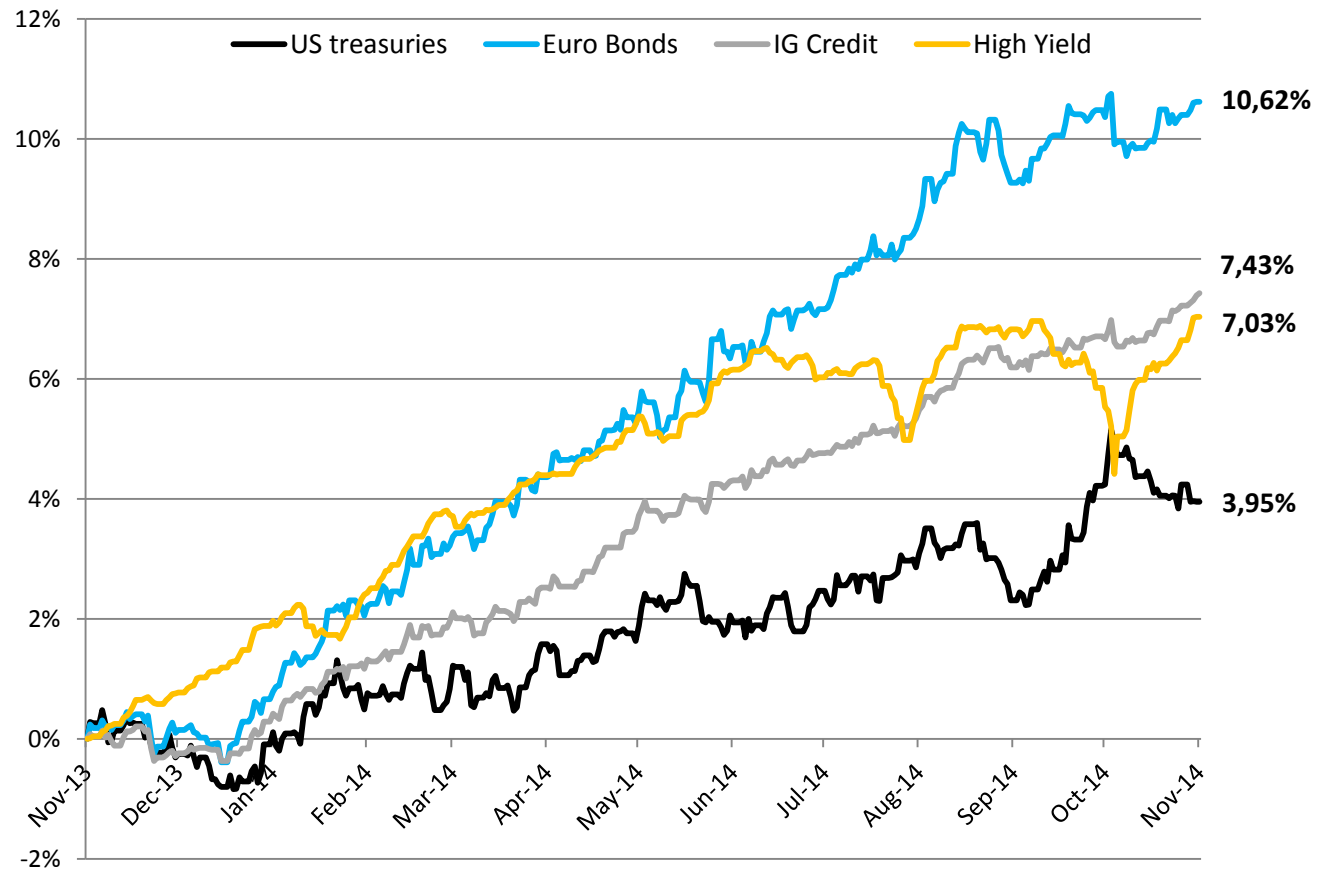
# Financial markets in 2014

- Bonds delivered higher returns than expected
  - Drivers: Deflationary scare, more monetary stimulus, recovery there but not very convincing yet and Geo-political tensions
- Equities delivered positive returns, but substantial regional difference
  - Europe earnings finally growing, but still a low pace vs US. Japanese equities benefitted from more QQE and Emerging markets not catching up yet

## Our Expected Returns

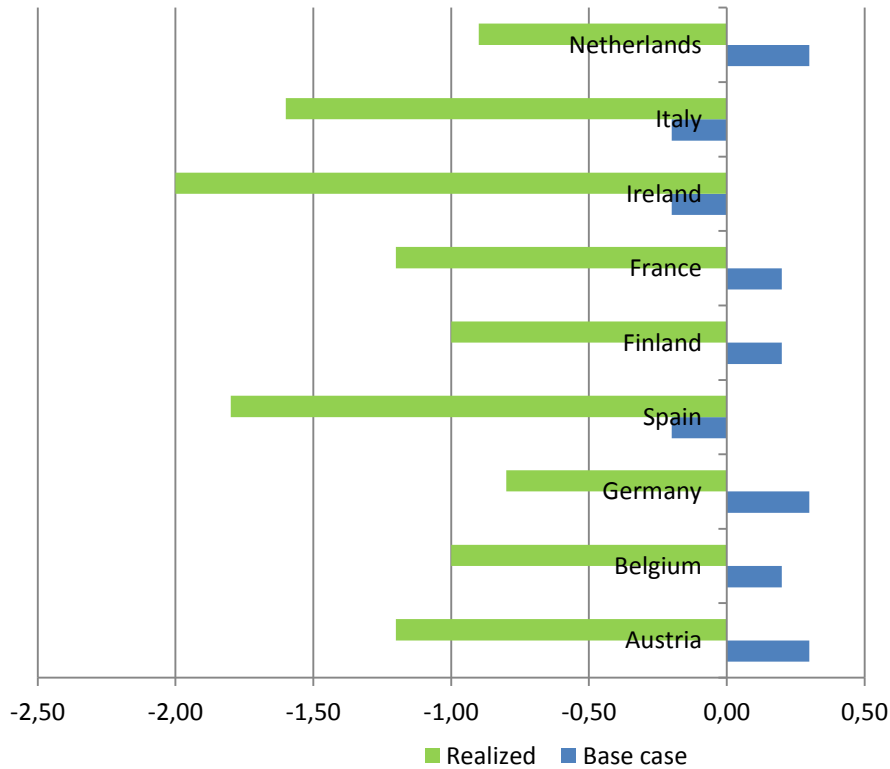


## Realized Returns



Returns over 12m as of 13-11-2013

Rate move Europe over 1yr

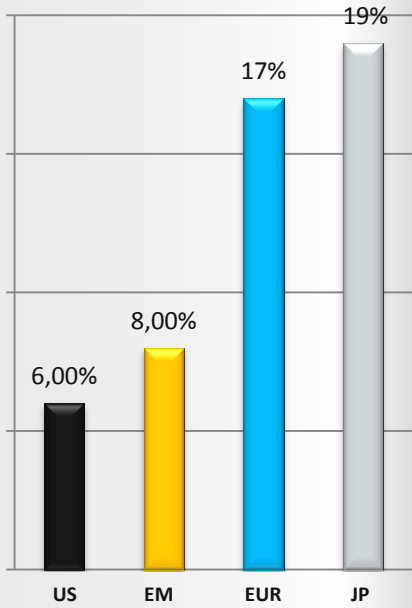


Impact rate move	<b>7.79%</b>
<i>Italy</i>	<b>2.24%</b>
<i>France</i>	<b>1.91%</b>
<i>Germany</i>	<b>1.12%</b>
<i>Spain</i>	1.05%
<i>Belgium</i>	0.45%
<i>Netherlands</i>	0.37%
<i>Austria</i>	0.37%
<i>Ireland</i>	0.18%
<i>Finland</i>	0.10%
Yield to worst	1.99%
Roll Down	0.78%
<b>Total Return</b>	<b>10.56%</b>

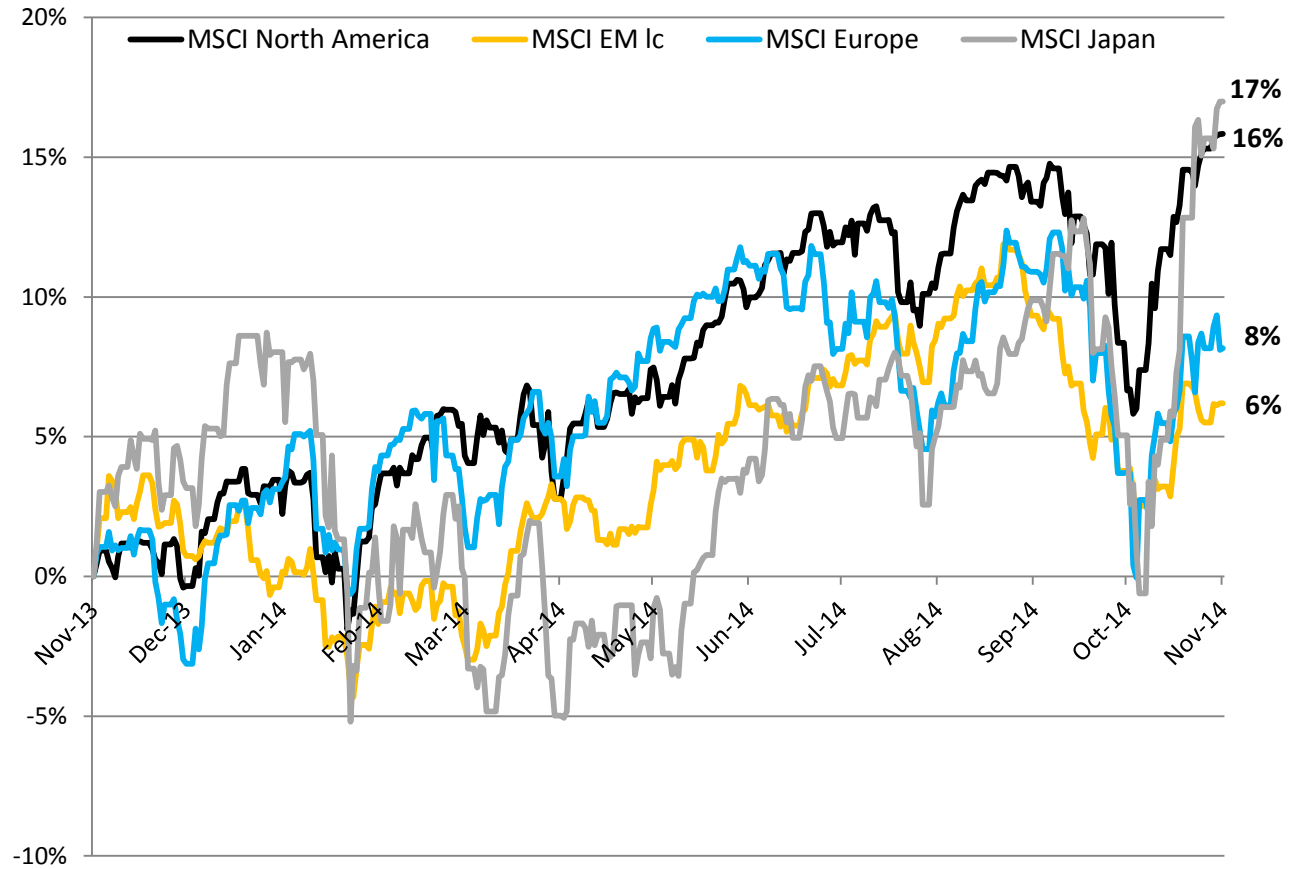
# Financial markets in 2014

# EQUITIES

## Our Expected Returns



## Realized Returns



Returns over 12m as of 13-11-2013

# Financial markets in 2014

# EQUITIES

	Projected Multiple	Current Multiple	Expected earnings growth	Consensus EPS 2014 earnings growth	realized Return
Europe	16x	16.4x	16%	3.80%	8%
US	16.3x	18.4x	10%	7.7%	16%
Emerging Markets	11.8x	12.5x	11.6%	3.60%	6%
Japan	20.5x	16x*	13%	12.6%	17%



Stimulative global monetary policy supportive of valuations



Disappointing growth in EM and EUR

\*Japans fiscal year ends in March, causing some distortions on historic multiples





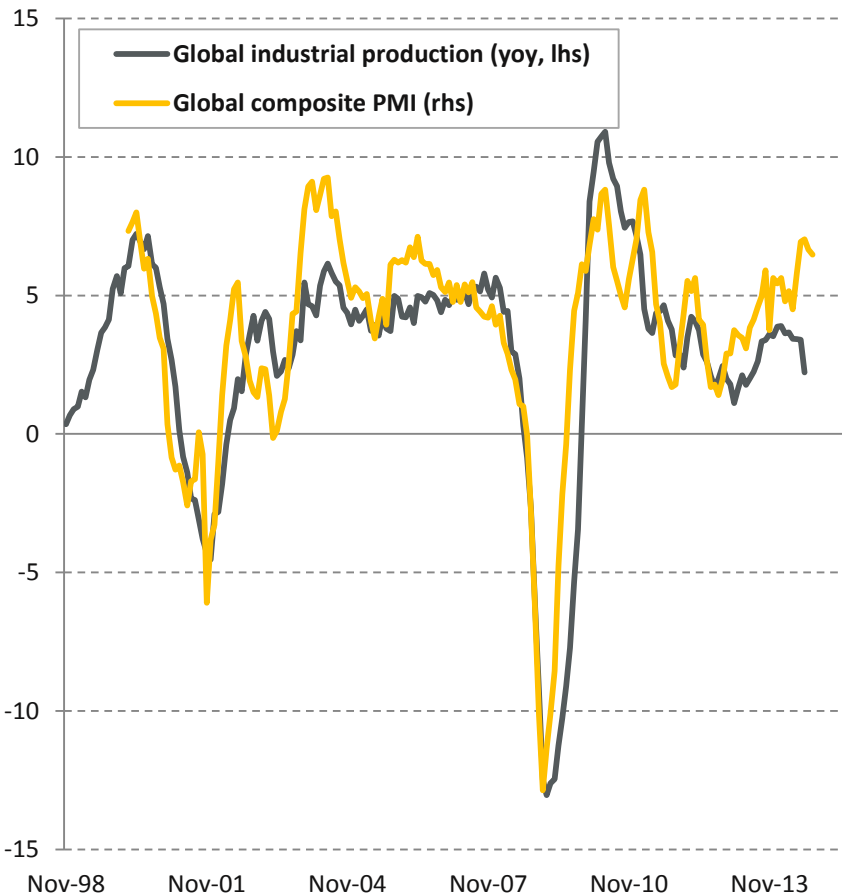
# 5 Macro themes for 2015

- Global recovery led by the US
- Eurozone does not implode
- China: managed slowdown instead of hard landing
- Inflation remains low
- Fed/BoE versus ECB/BoJ

# Global leading indicators: mixed picture

## Business confidence

## Oil



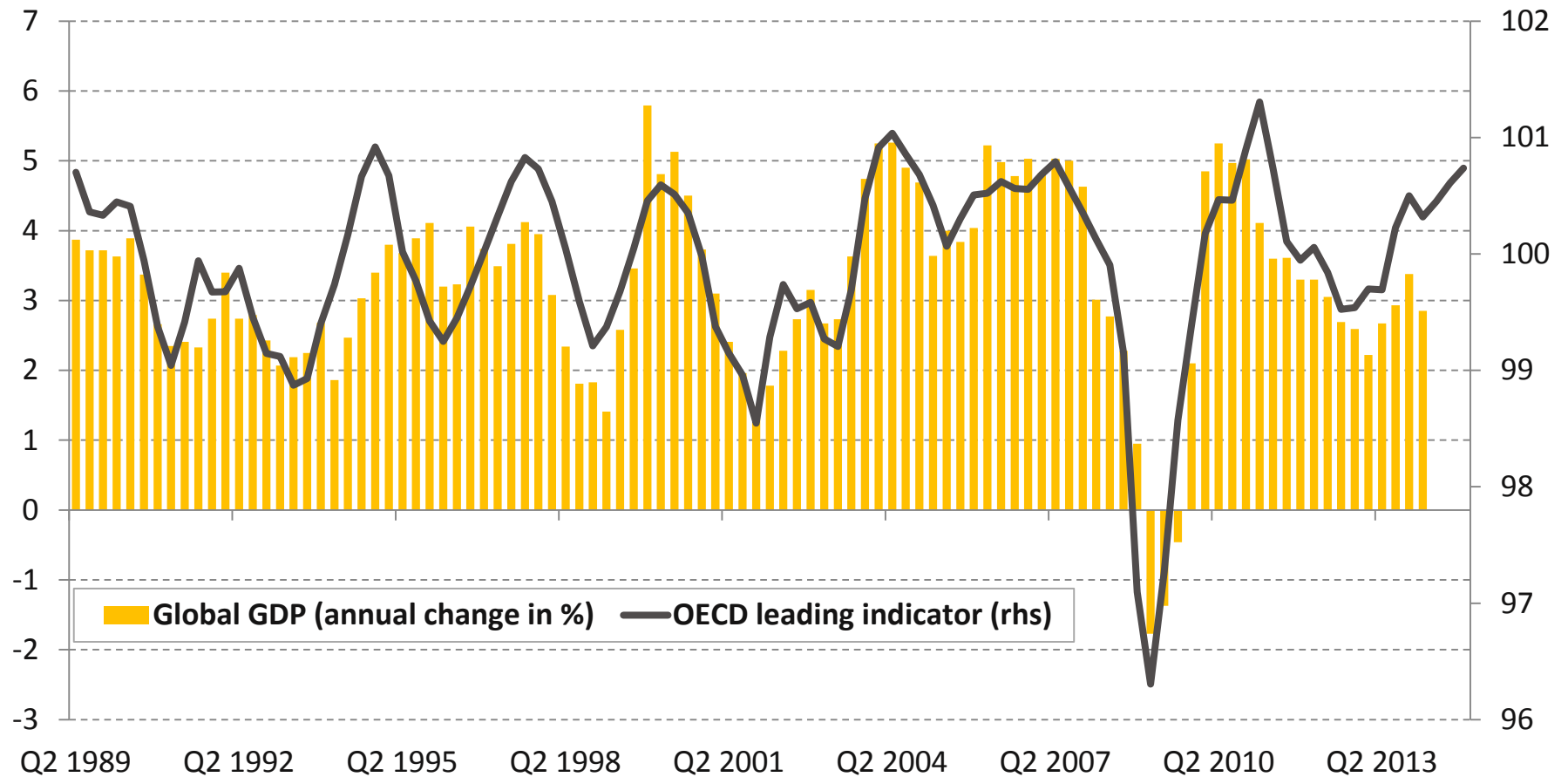
# Slow recovery is not exceptional

Table 2. Descriptive Statistics for 100 Financial Crises, 1857-2013: Percent Decline in Per Capita GDP, Duration of Contraction, Years to Full Recovery, and Severity Index

Descriptive statistic	% change		Number of years		Severity index
	Peak to trough	Peak to trough	Peak to recovery	Peak to recovery	
<i>100 Crises: Full sample</i>					
Mean	-11.3	3.0	8.4	19.6	
Median	-8.6	2.0	6.5	15.8	
Standard deviation	9.1	2.2	6.2	14.0	
Share of episodes with double dip					43.0
<i>63 Crises: Advanced economies</i>					
Mean	-9.6	2.9	7.4	17.0	
Median	-7.1	2.0	6.0	13.0	
Standard deviation	7.8	1.9	5.2	12.2	
Share of episodes with double dip					42.9
<i>37 Crises: Emerging markets</i>					
Mean	-14.2	3.2	9.9	24.2	
Median	-13.3	2.0	8.0	22.1	
Standard deviation	10.4	2.7	7.4	15.9	
Share of episodes with double dip					43.2
<i>Difference in means test (emerging minus advanced)</i>					
Difference	-4.7	0.3	2.5	7.2	
<i>p</i> value	0.020**	0.523	0.072	0.020**	

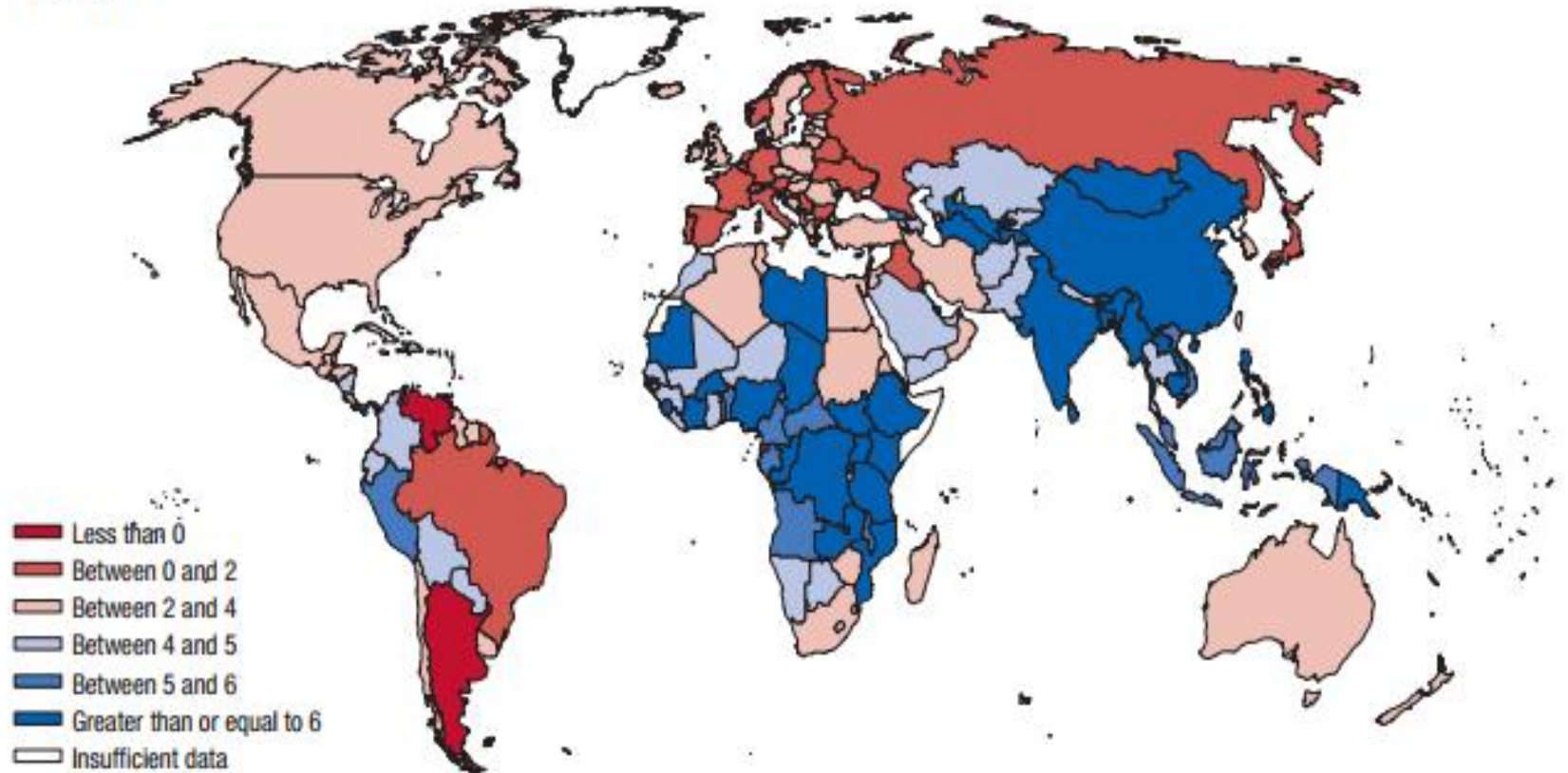
Source: Reinhart&Rogoff

# Global recovery

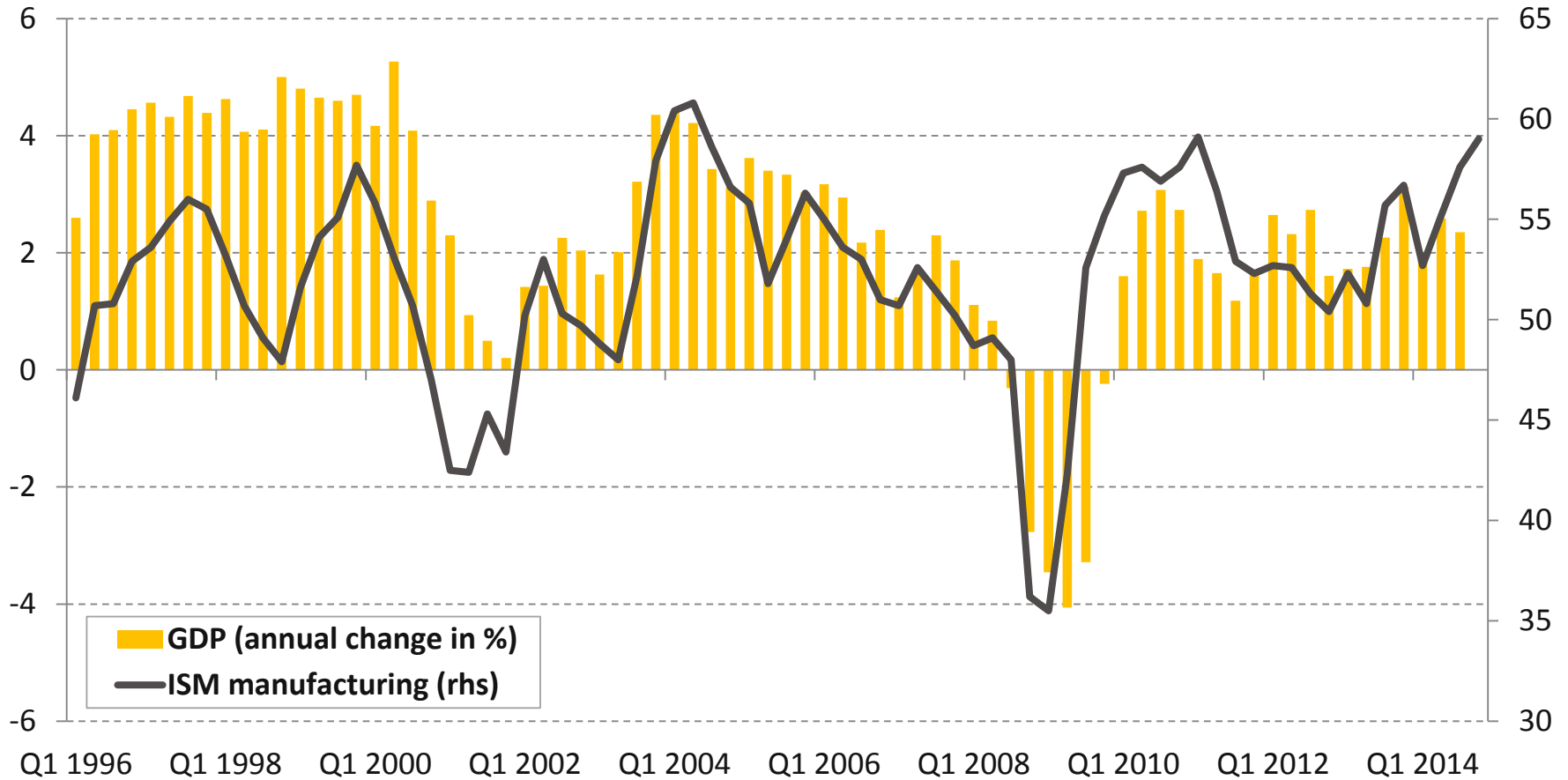


# Uneven global recovery

1. 2015 GDP Growth Forecasts<sup>1</sup>  
(percent)



# US on track for over 3% growth in coming quarters



# Global outlook: recovery should continue for years



→ Sharp increase in interest rates

→ Fiscal tightening

→ Geopolitics

→ China crash

→ Bubbles/runaway inflation



→ Under control inflation

→ Supportive monetary policy

→ Restoring credit mechanism

→ Increasing confidence

→ Normalisation





# 5 Macro themes for 2015

→ Global recovery led by the US

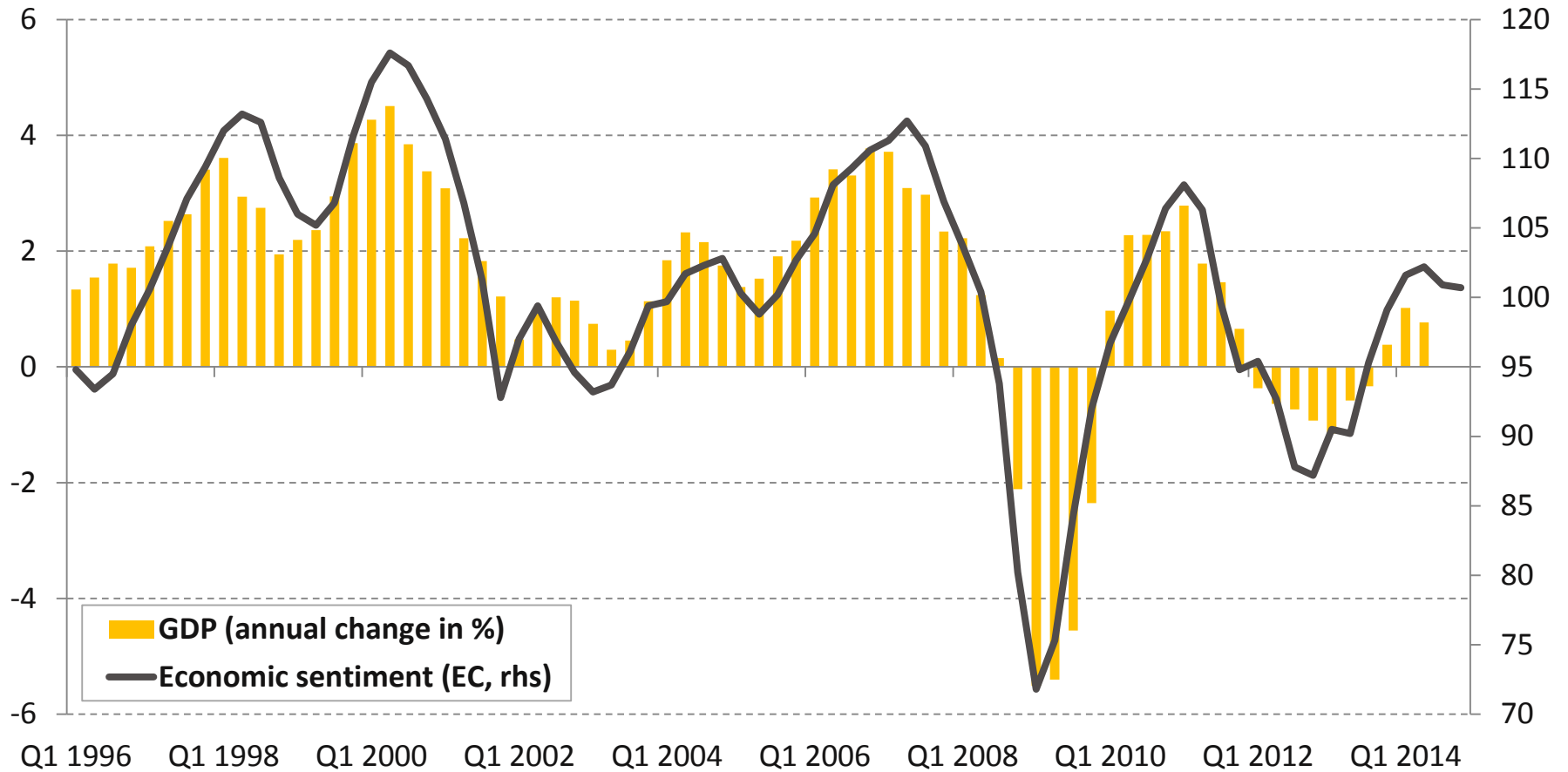
→ Eurozone does not implode

→ China: managed slowdown instead of hard landing

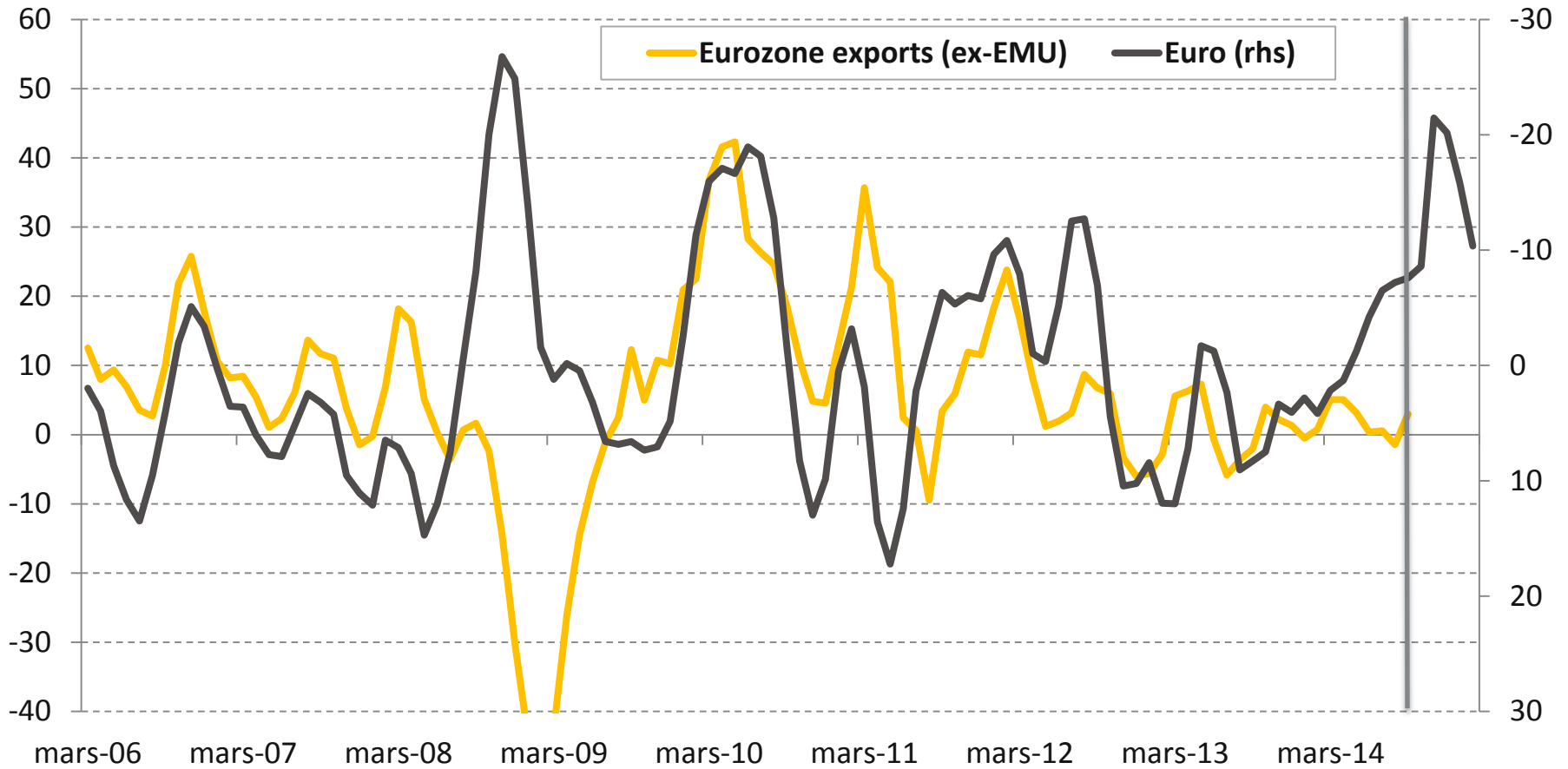
→ Inflation remains low

→ Fed/BoE versus ECB/BoJ

# Eurozone on track for 1% growth

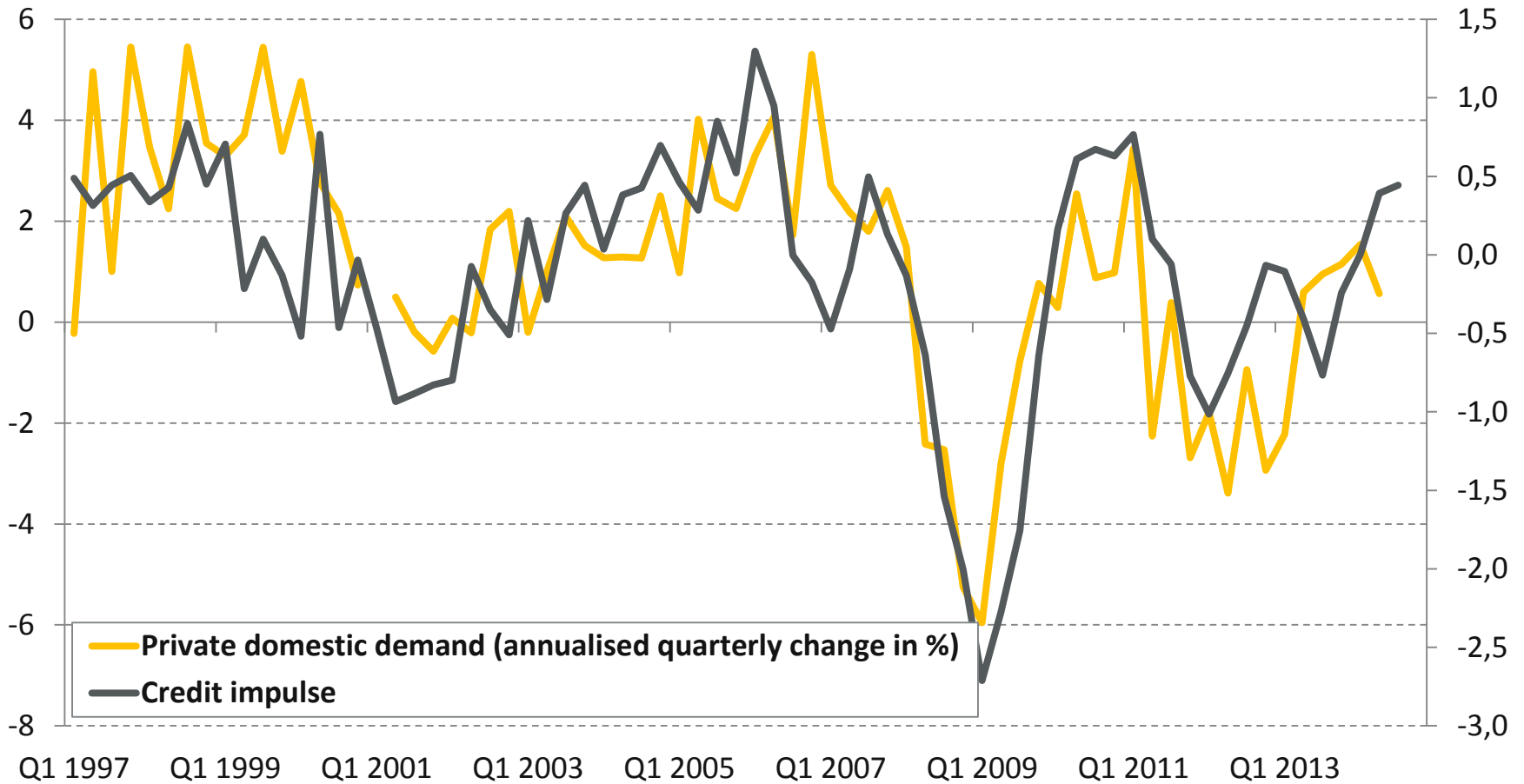


# Euro depreciation should really boost exports



# Eurozone credit mechanism showing signs of life

Credit impulse





# 5 Macro themes for 2015

→ Global recovery led by the US

→ Eurozone does not implode

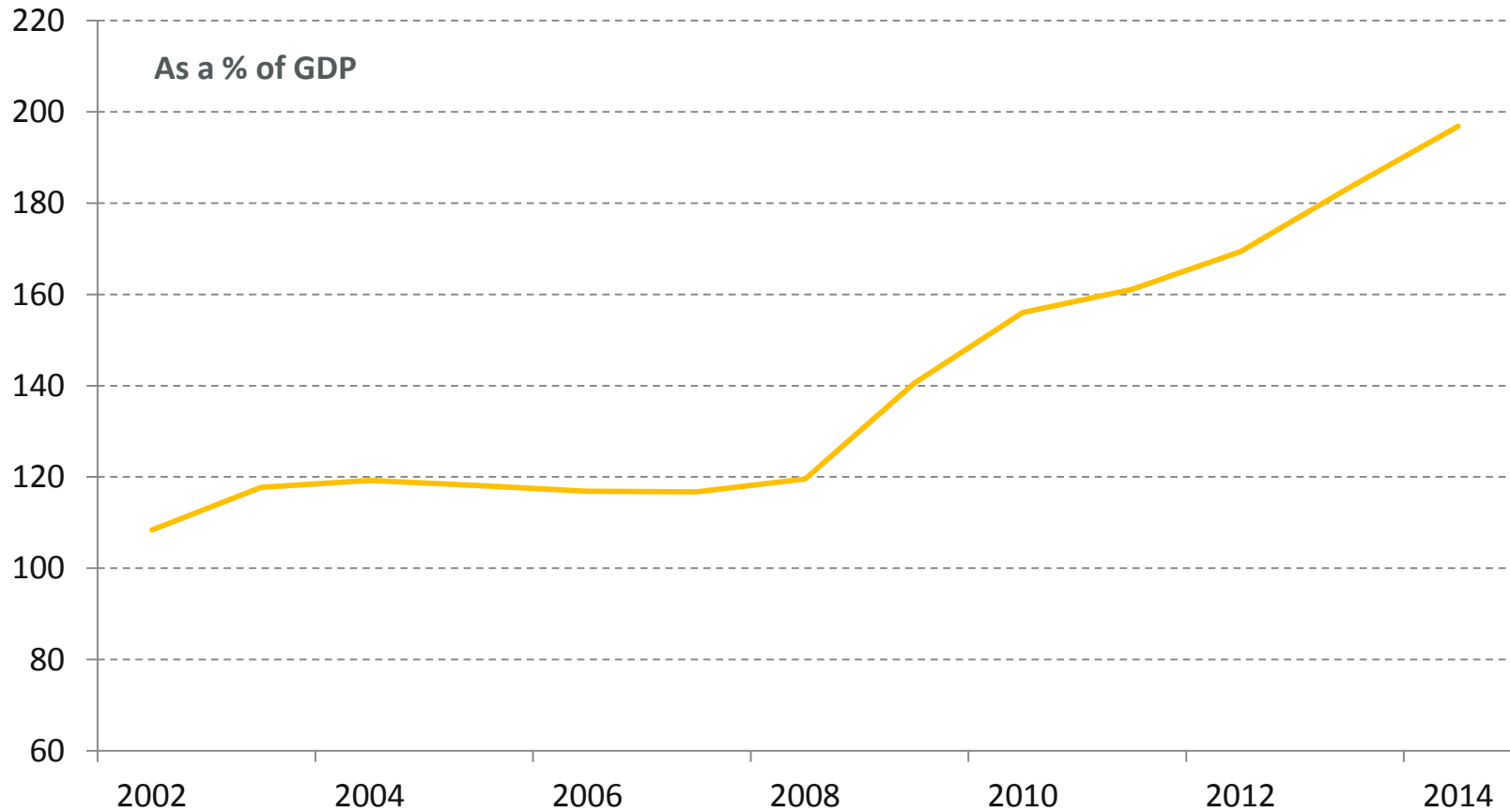
→ China: managed slowdown instead of hard landing

→ Inflation remains low

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# China is too dependent on credit

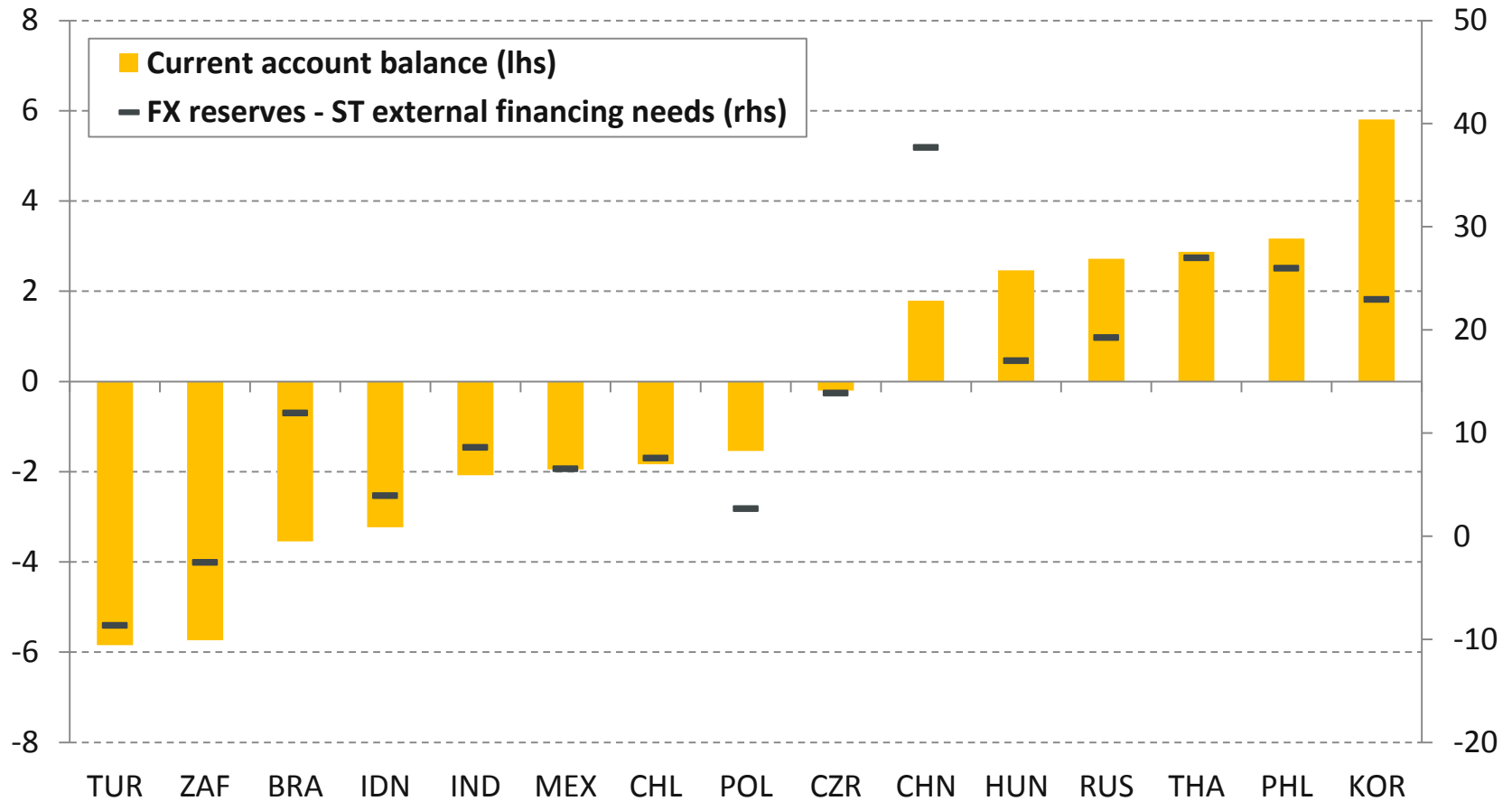
Total social financing



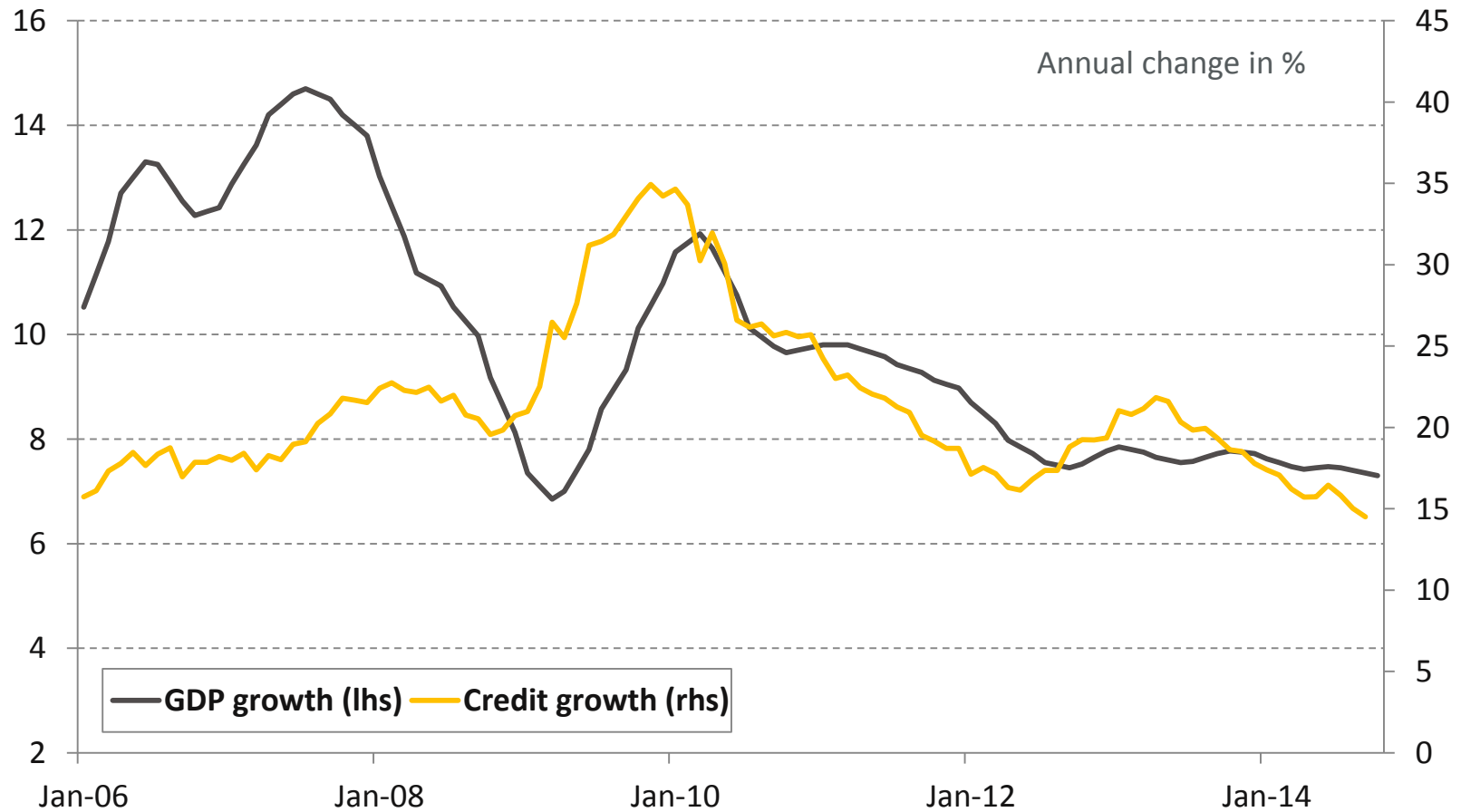


# China cannot be pushed into crisis by external pressures

External vulnerability



# China continues to manage slowdown

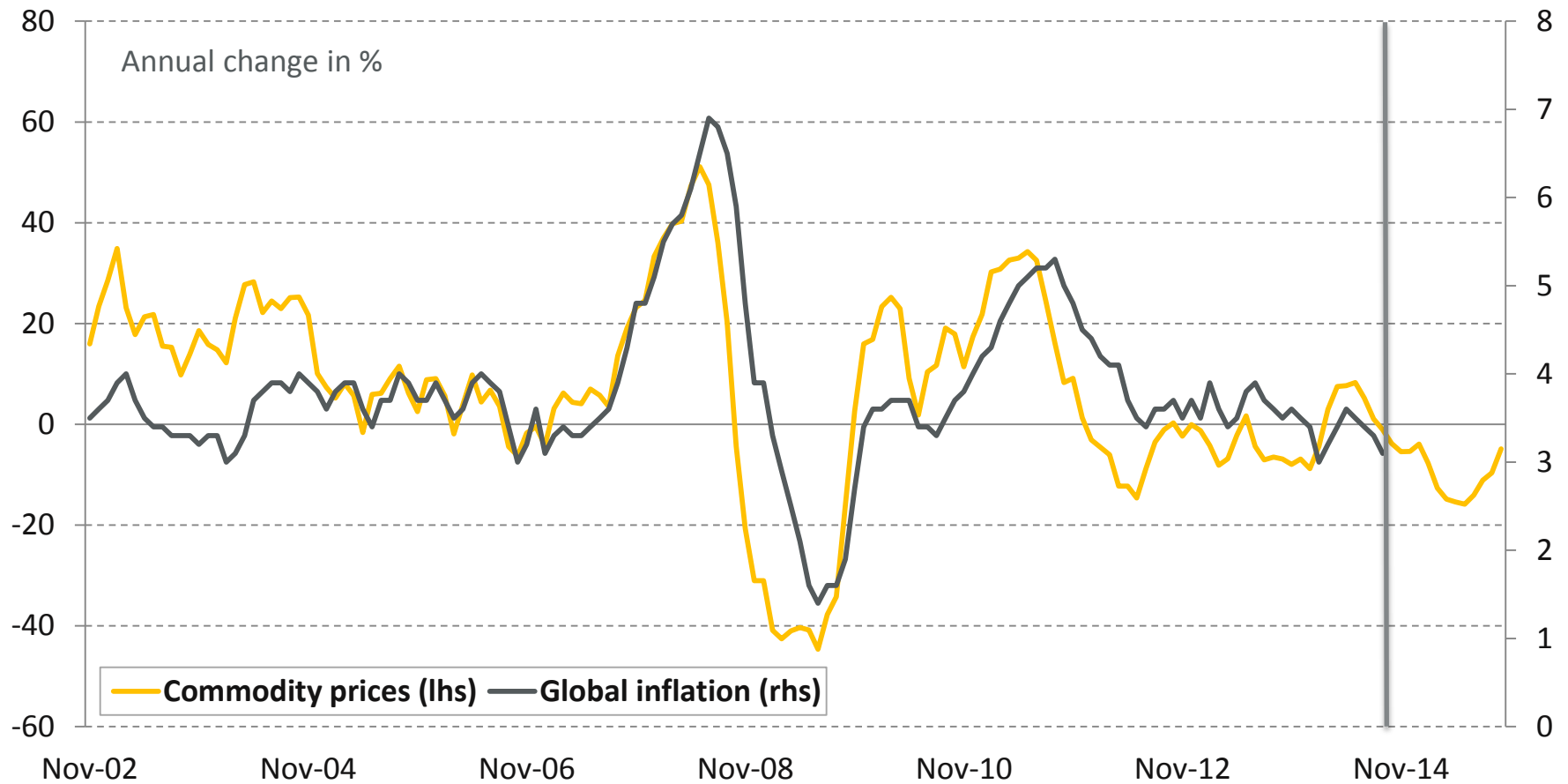




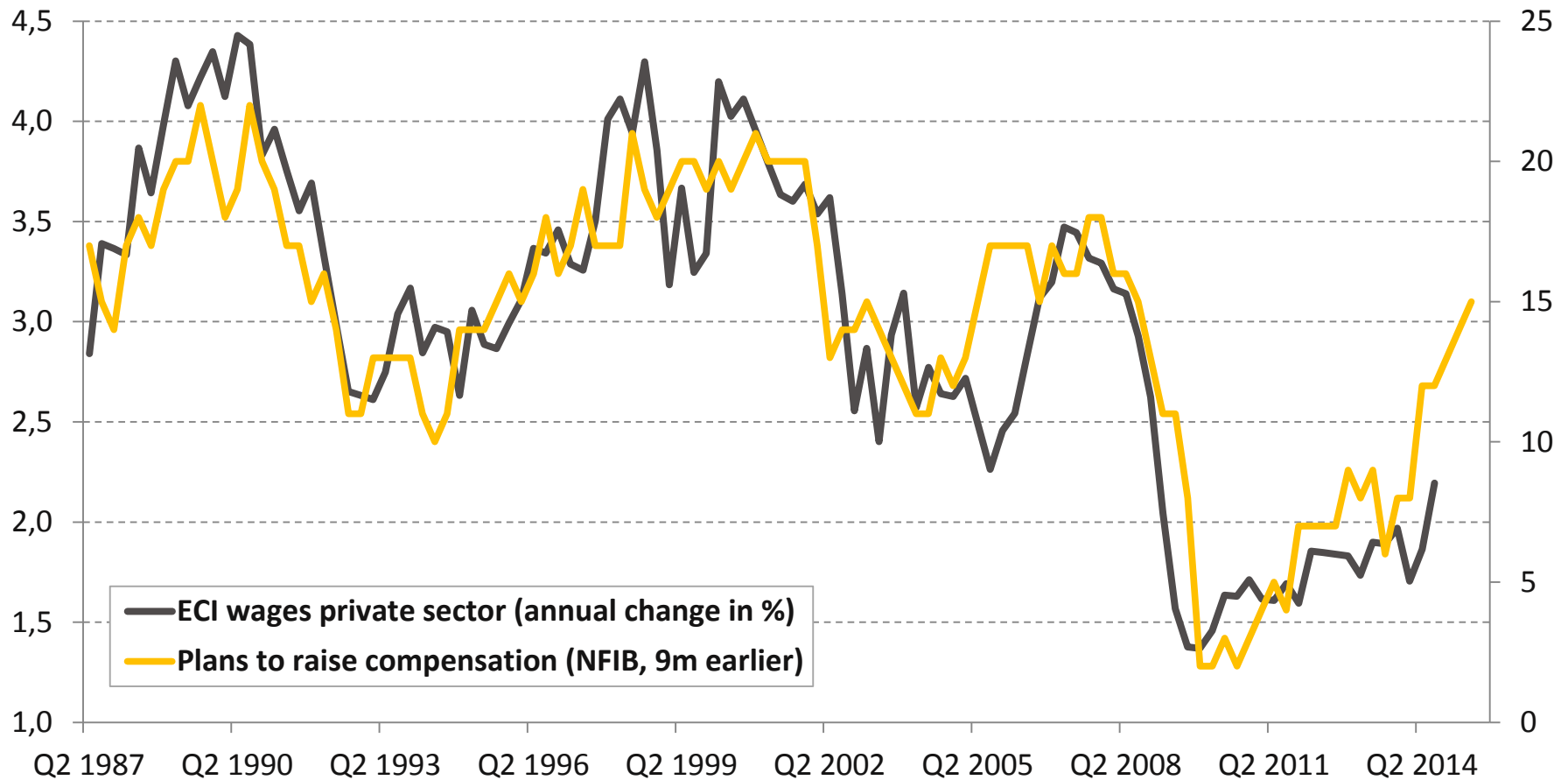
# 5 Macro themes for 2015

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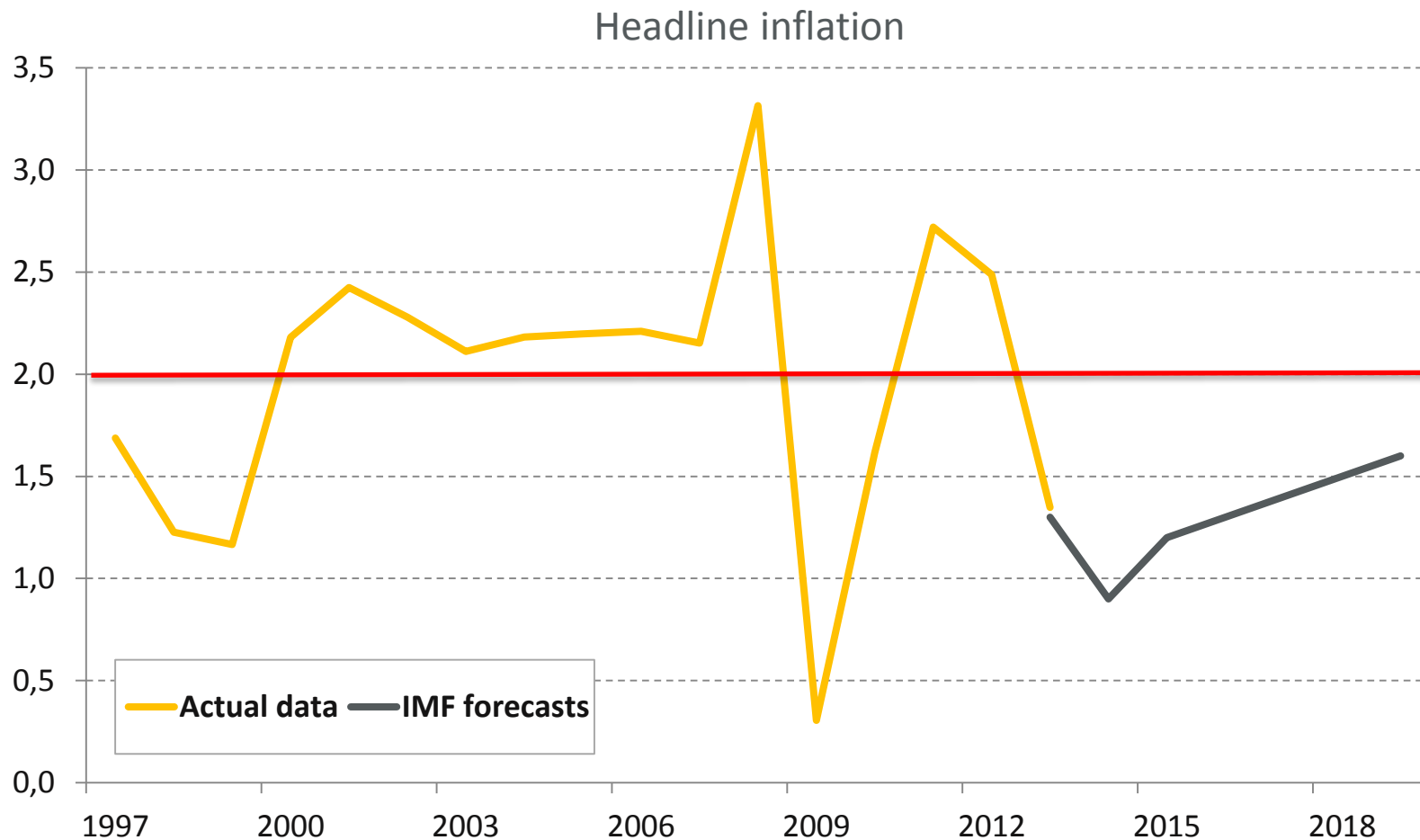
# Global inflation heading lower



# Hints of inflation appearing in the US



# No inflationary pressures in the Eurozone





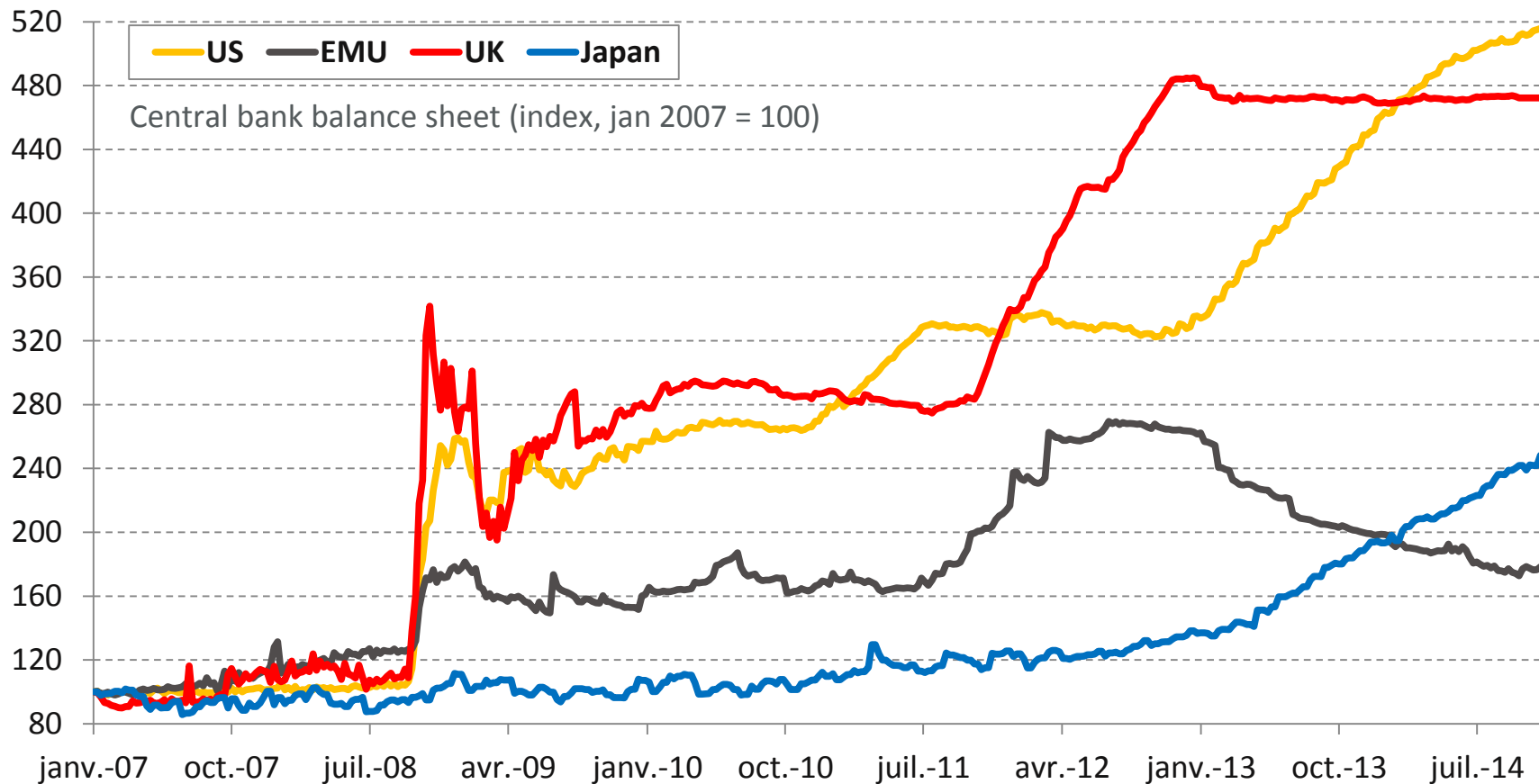


# 5 Macro themes for 2015

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# Diverging monetary policy

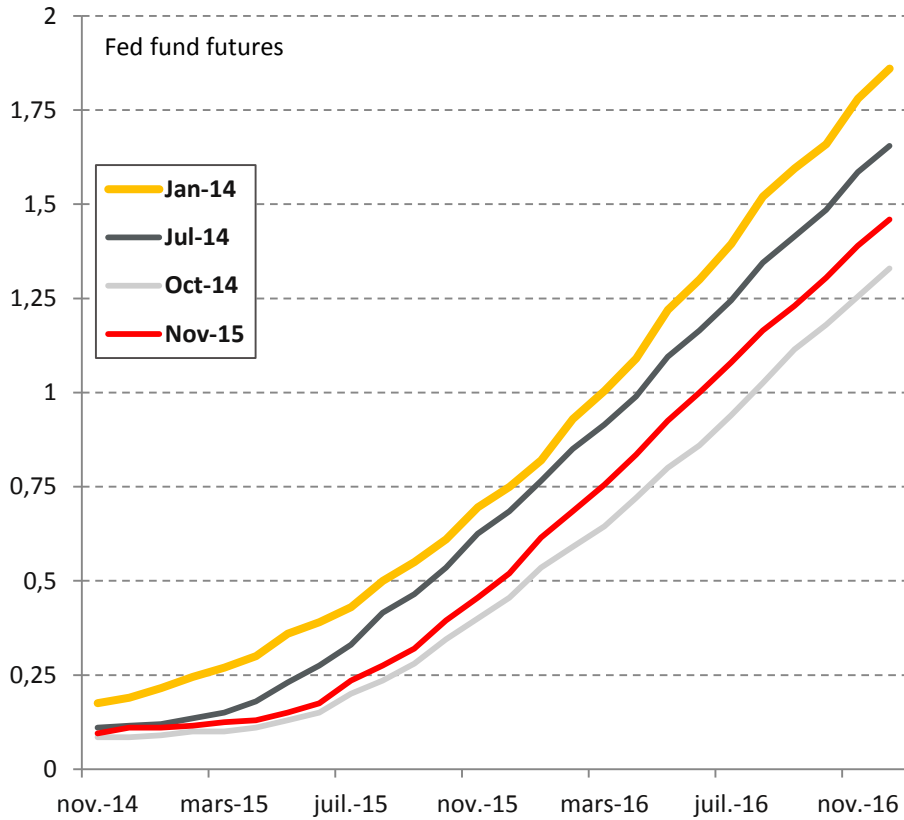
## Printing money



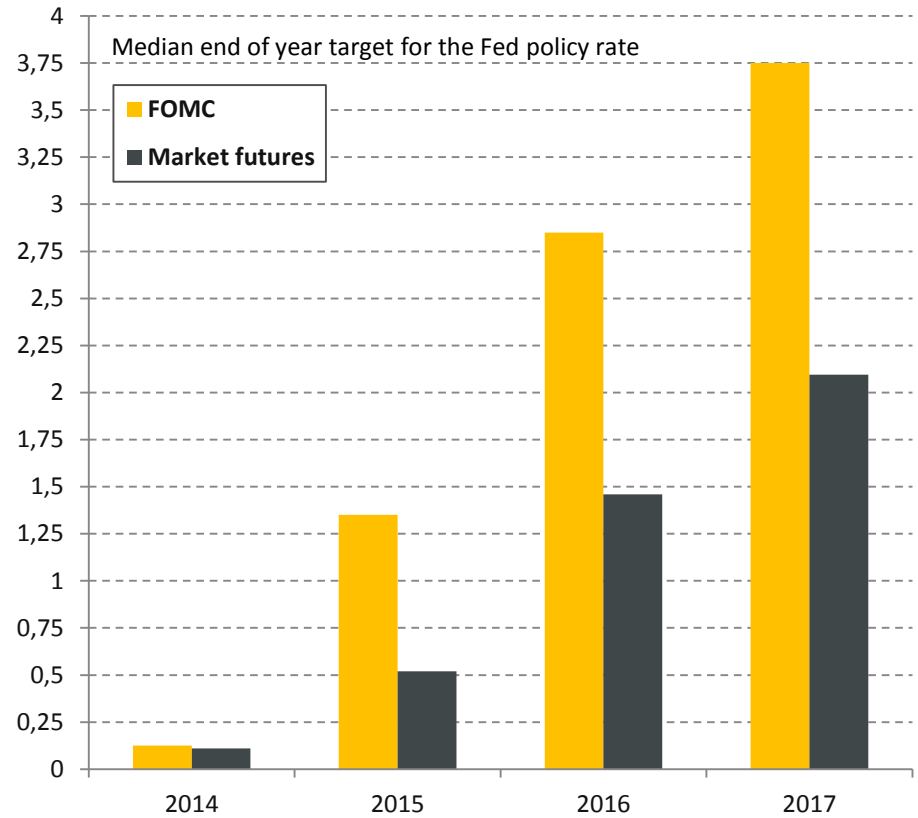


# Expectations for the Fed policy rate

Market



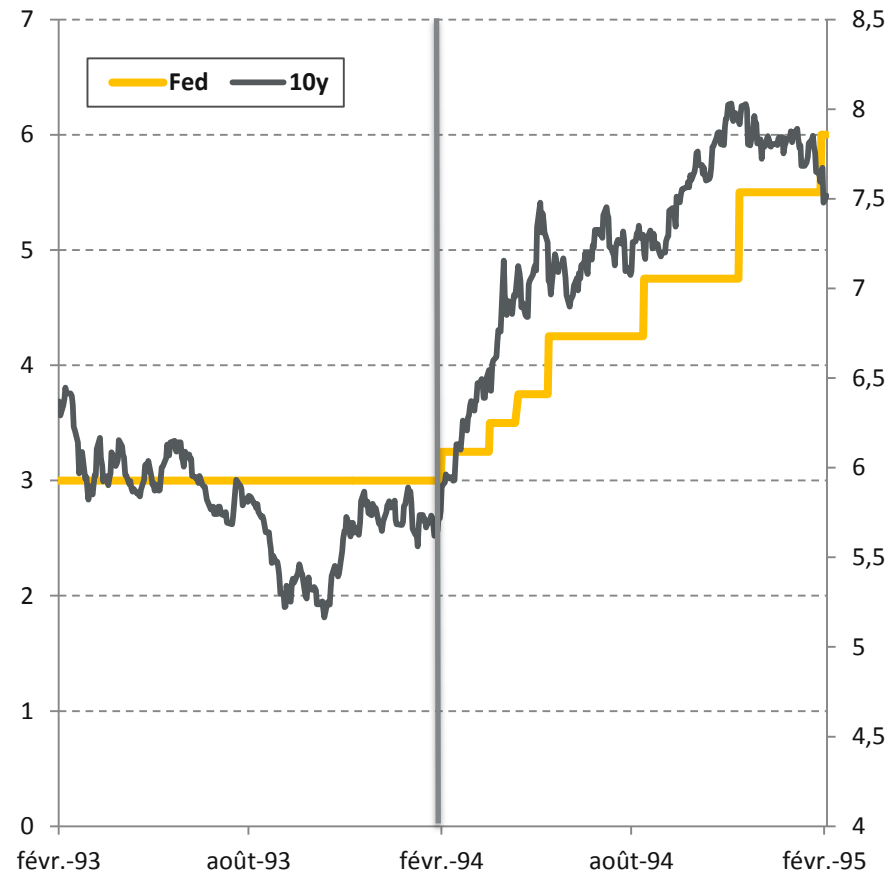
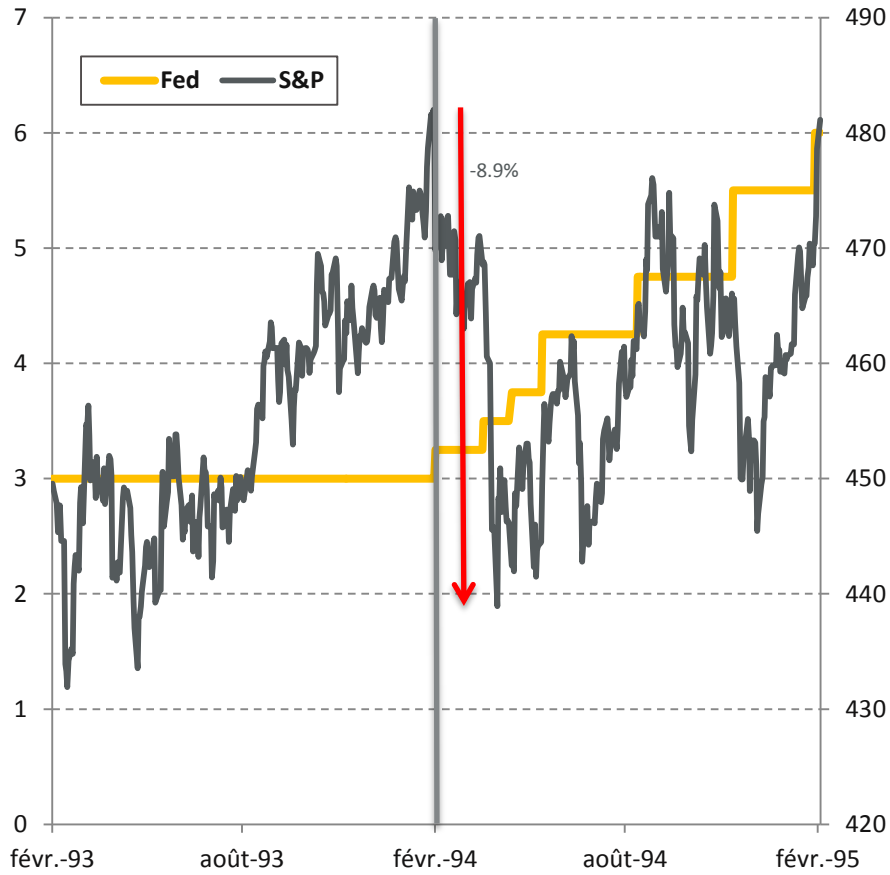
Fed



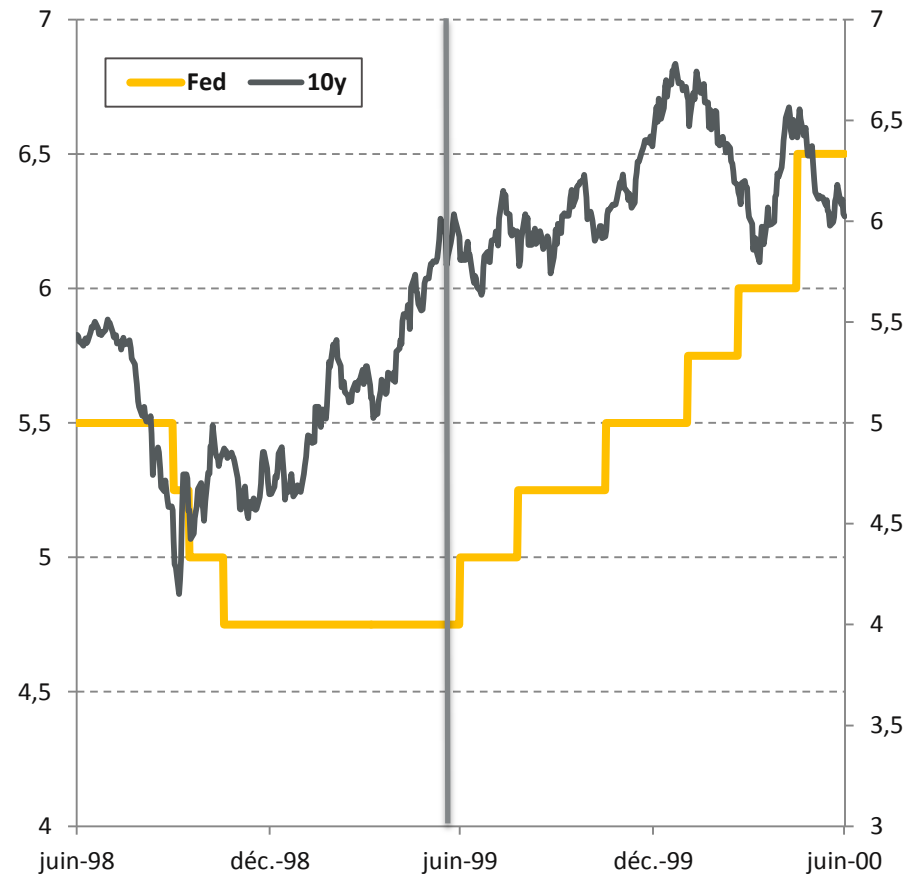
# 1987



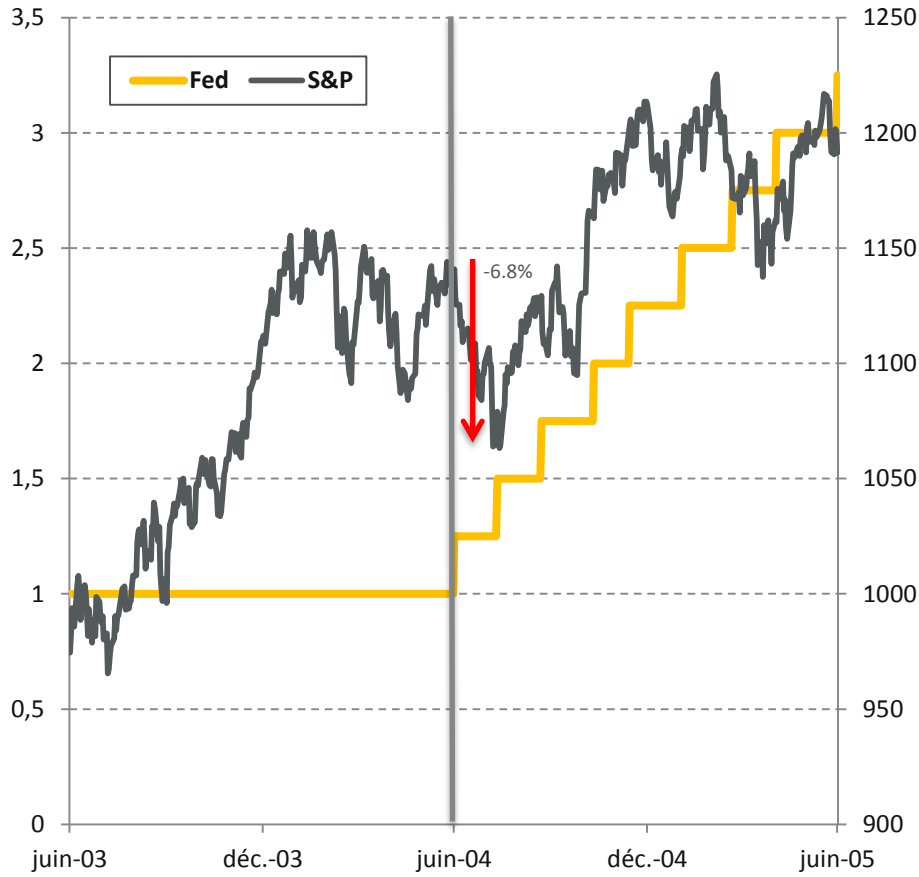
# 1994



# 1999

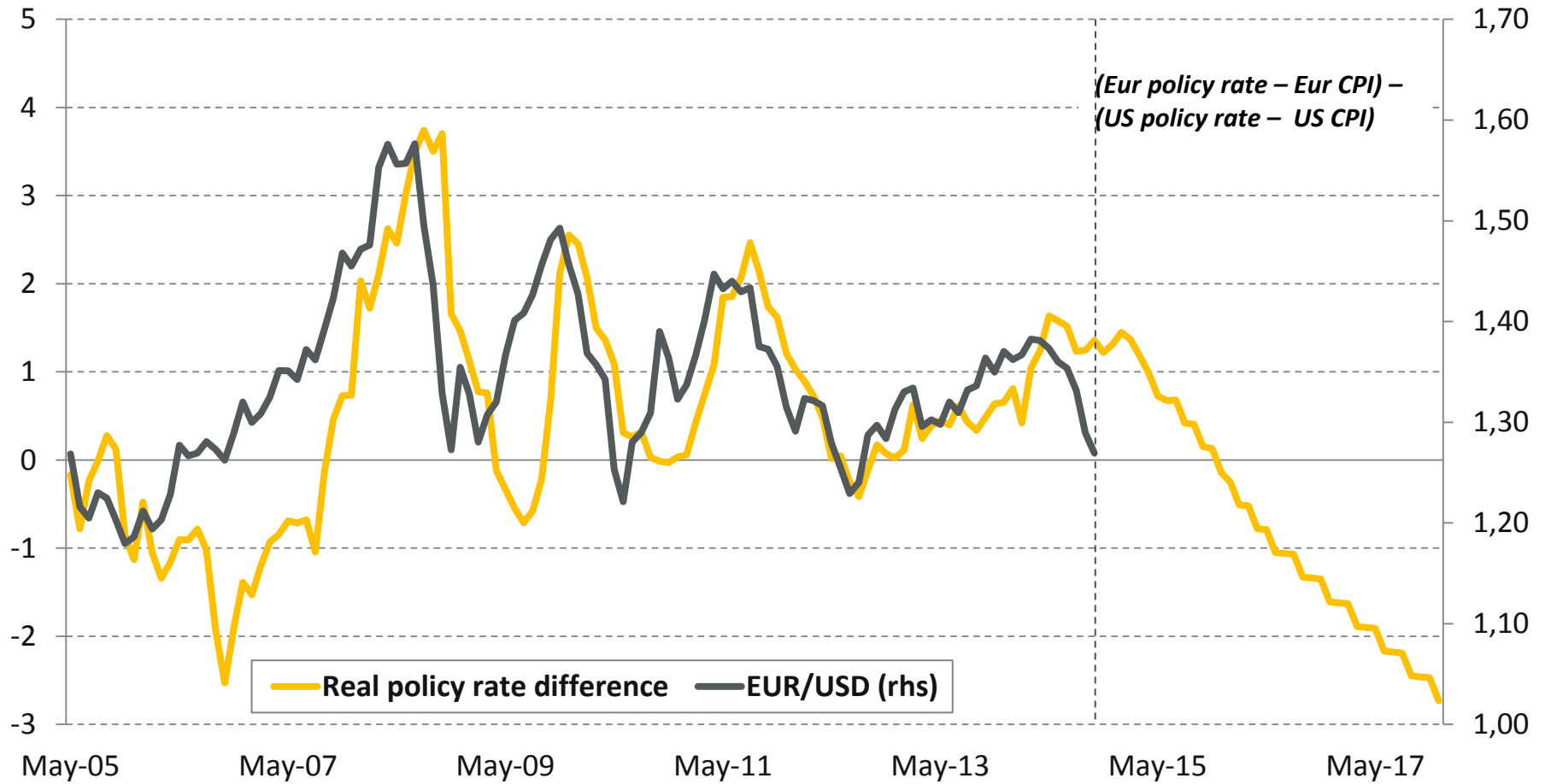


# 2004





# Diverging policy ECB-Fed should push up USD vs EUR



# 5 Macro themes for 2015

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# Risks



# Risks

- Draghi quits
- Fed behind the curve
- Japanese experiment fails
- Chinese implosion

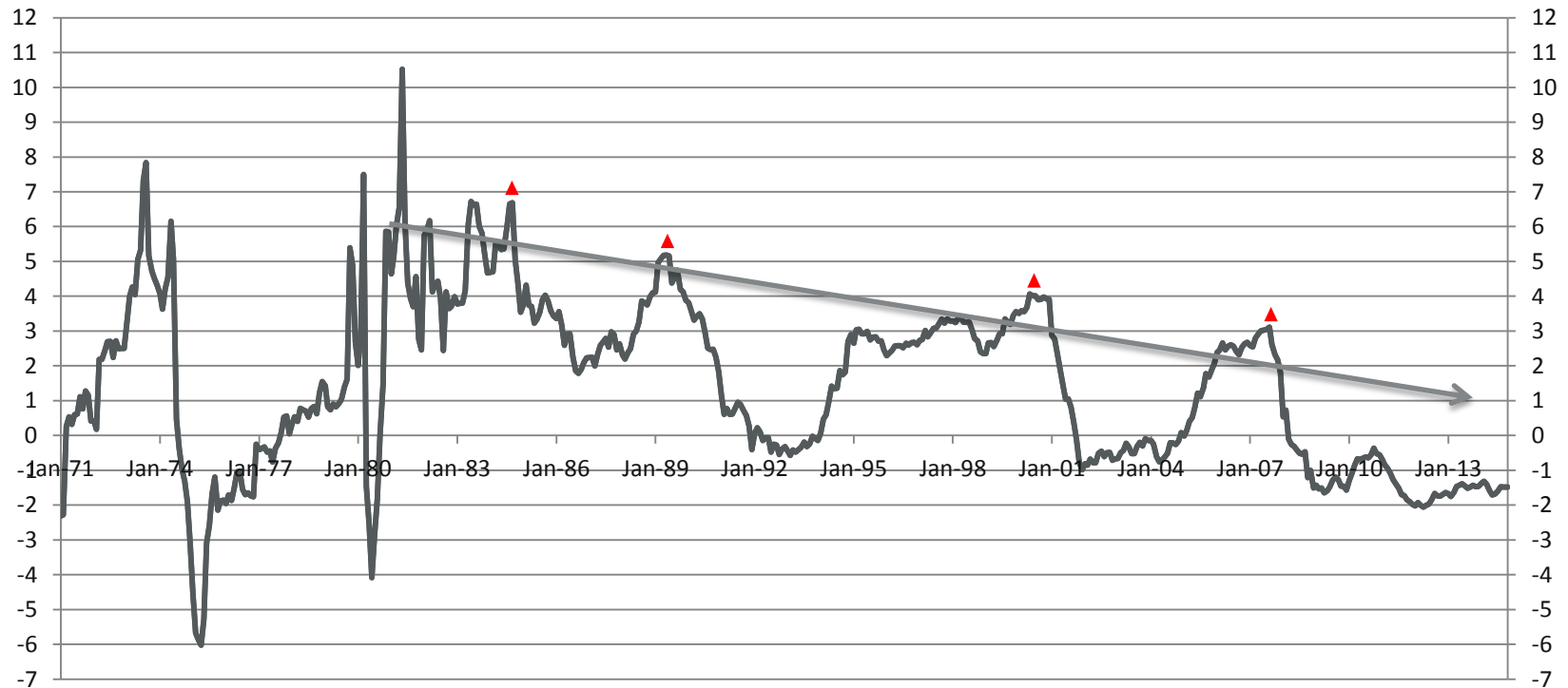
# Outlook 2015 Financial Markets

- Rates low for longer (but volatility will rise)
- FED policy will impact (risky) assets
- Valuations leave little room for disappointments
- Structural reforms (in EU, JP & EM) and cyclical tail-winds can be positive catalyst

# US Government Bond market

➔ Peak in FED Fund Target rate lower then previous peaks

## Real FED Fund rate



Source: Bloomberg

— FED FUND Rate - Core CPI

# US Government Bond market

→ 3 scenario's: (1) Back to QE, (2) Forwards or (3) Fed Dots

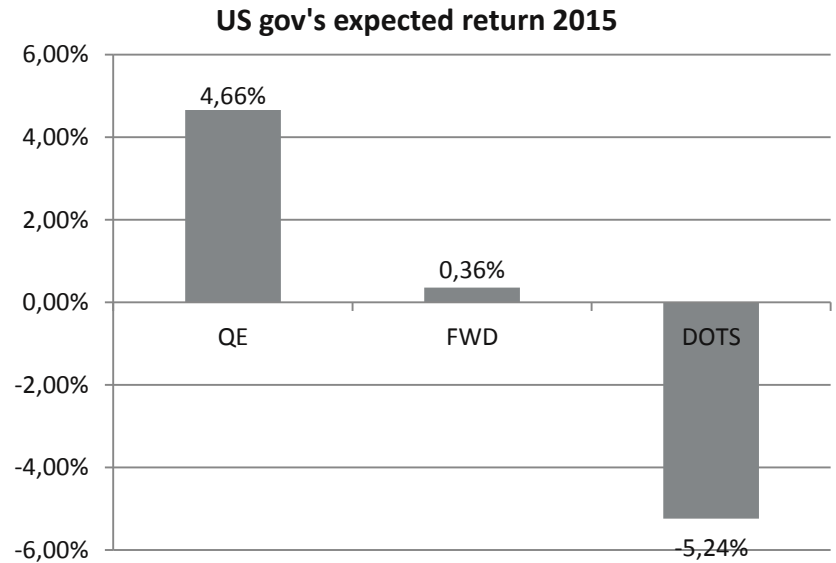
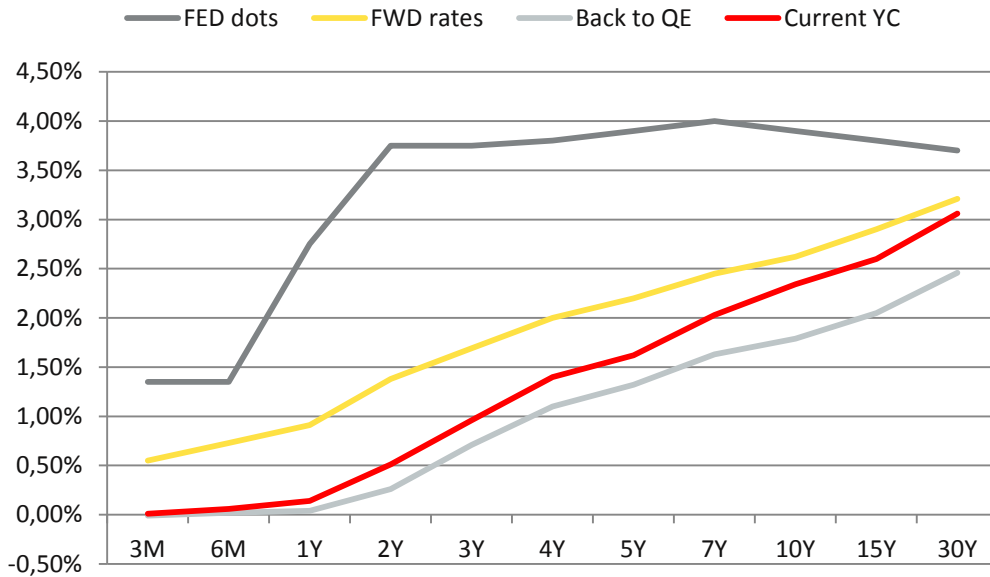
Moves implied over Current Yield Curve



Yield curve as of 17-11-2013

# US Government Bond market

## → 3 scenario's: Curves & Return potential

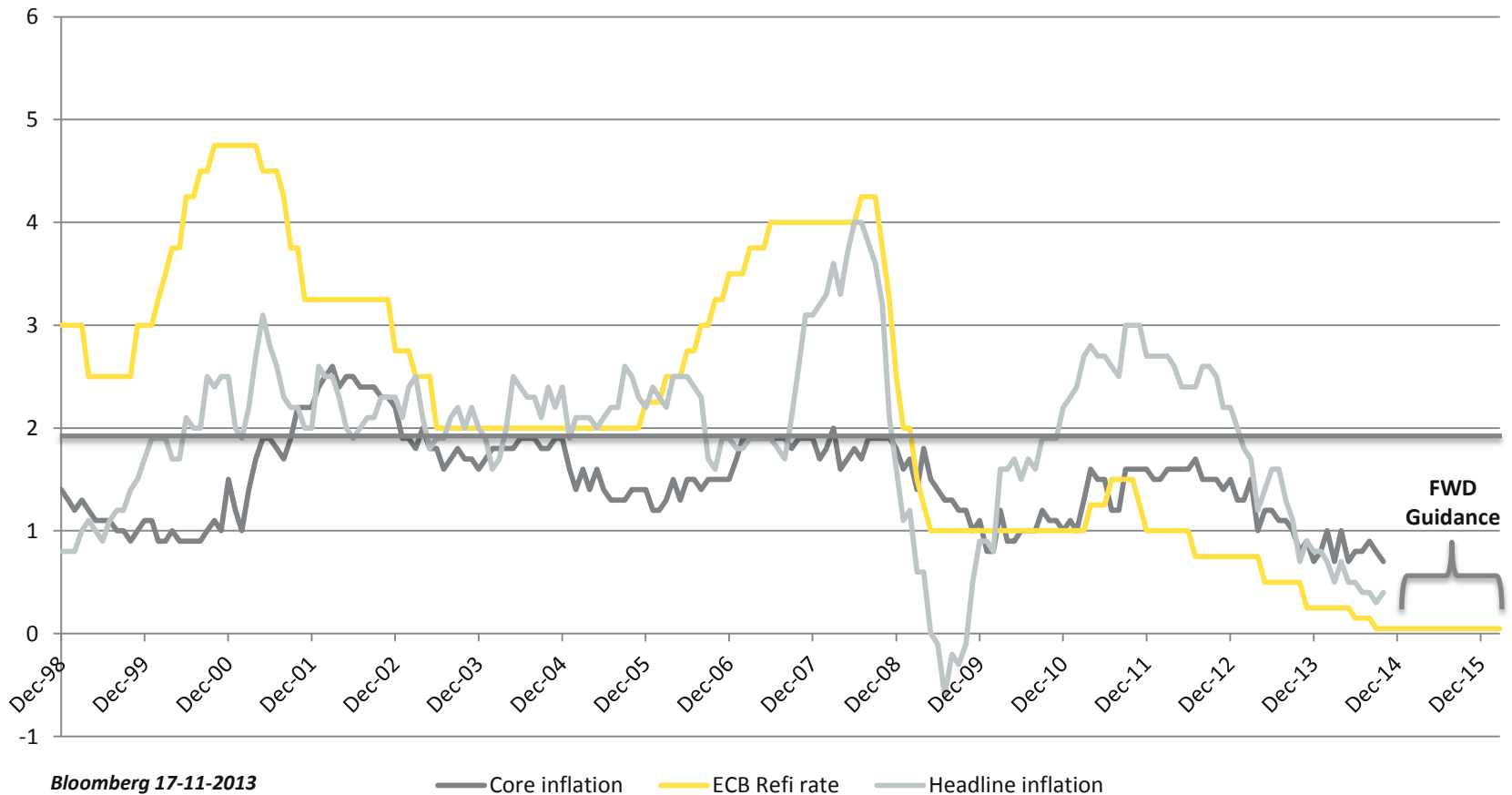


12M forward as of 17-11-2013



# EUR Government Bond market

➔ No inflationary pressures in Europe



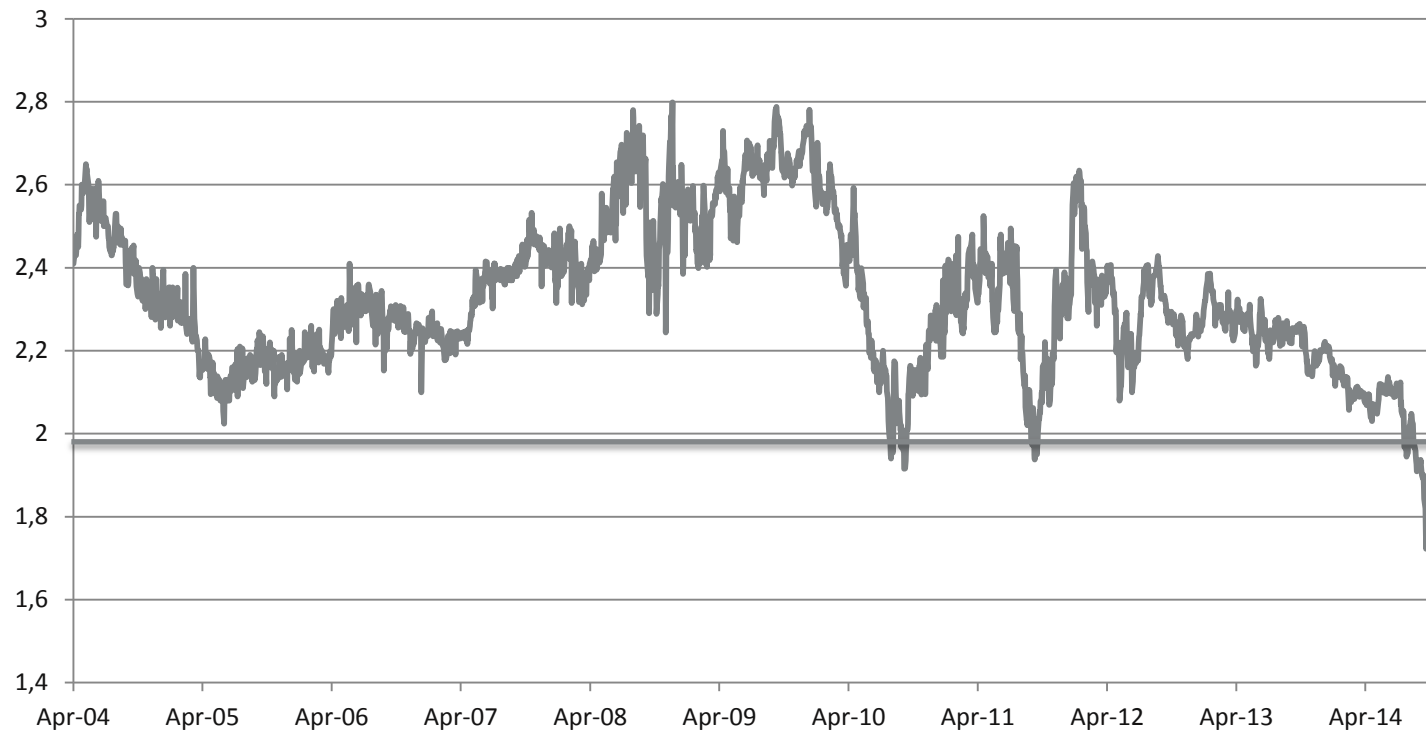
Bloomberg 17-11-2013

— Core inflation — ECB Refi rate — Headline inflation

# EUR Government Bond market

➔ No inflationary pressures on the horizon in Europe

EUR INFLATION SWAP FWD 5YR5YR



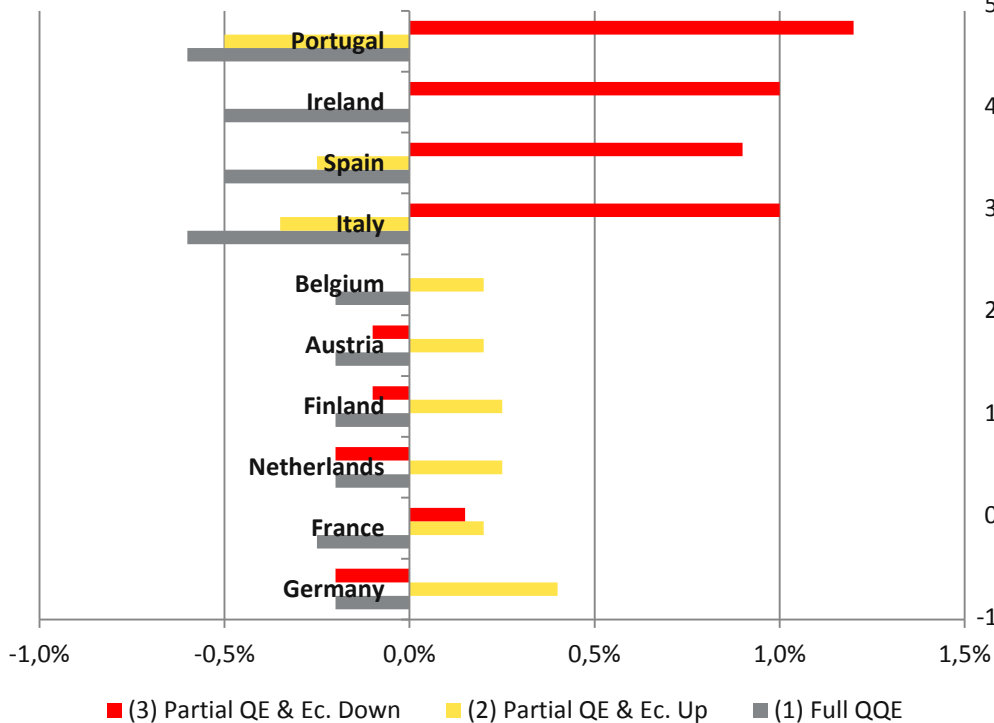
Bloomberg as of 17-11-2013

— EUR INFLATION SWAP FWD 5YR5YR

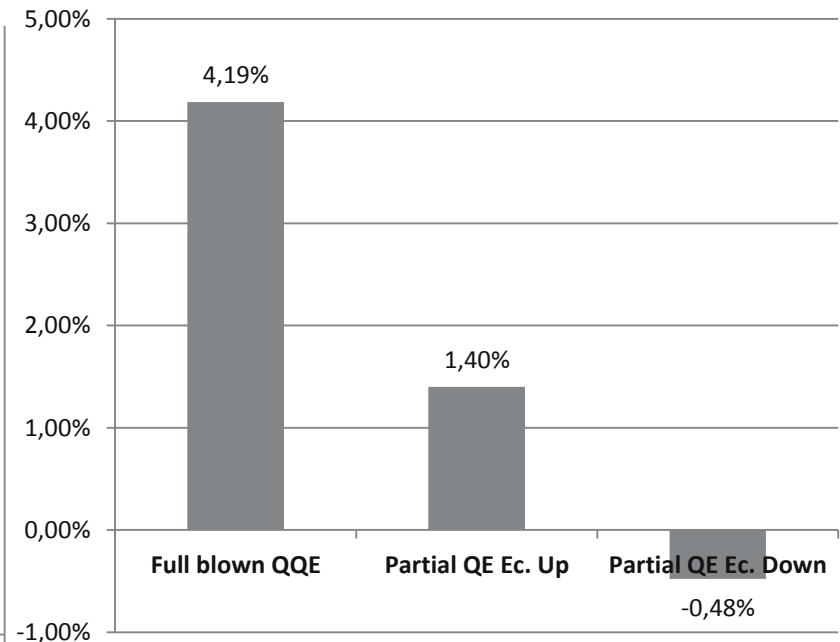
# EUR Government Bond market

- 3 scenario's: (1) Full QQE, (2) partial QE & Growth, (3) partial QE & No growth

Rate shift implied over Current Yield Curve



EUR Gov's expected return 2015



12M forward as of 17-11-2013

# EUR IG Credit market

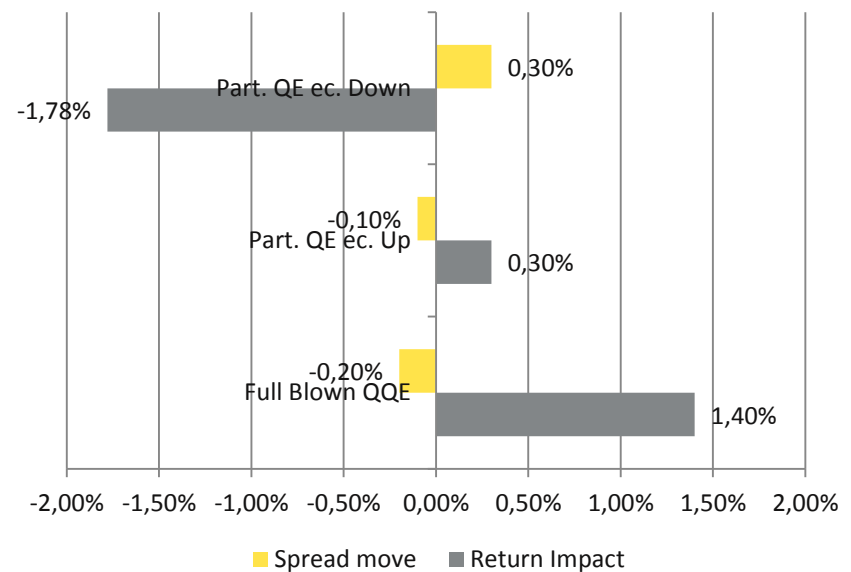
→ ECB will put downward pressure on spreads

→ **Full blown QQE** → very positive in the short run for IG credit

→ **Partial QE and economic recovery** → positive for IG credit Short and mid term

→ **Partial QE and disappointing economic momentum** → balance between fundamentals and flows.

→ Some need for liquidity premium since market has become less liquid



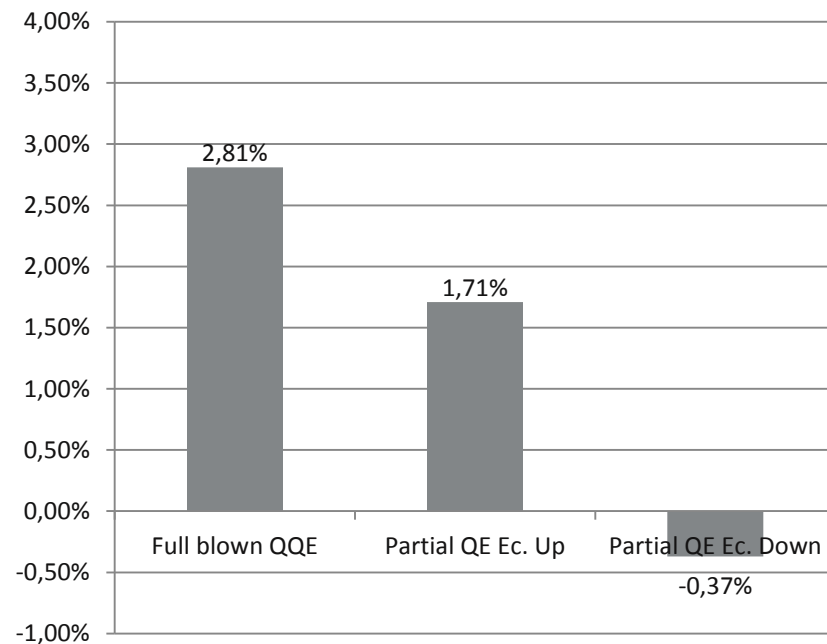
*Spread moves as of 17-11-2013*

# EUR IG Credit market

## → Total return potential EUR IG credit market in the 3 scenarios

- Search for yield continues
- Euro corporate credit YTW = 1.16%
- Roll down provides approximately 0.25% return
- **Idiosyncratic risk is going up → credit selection becomes even more important**

EUR Credit's expected return 2015



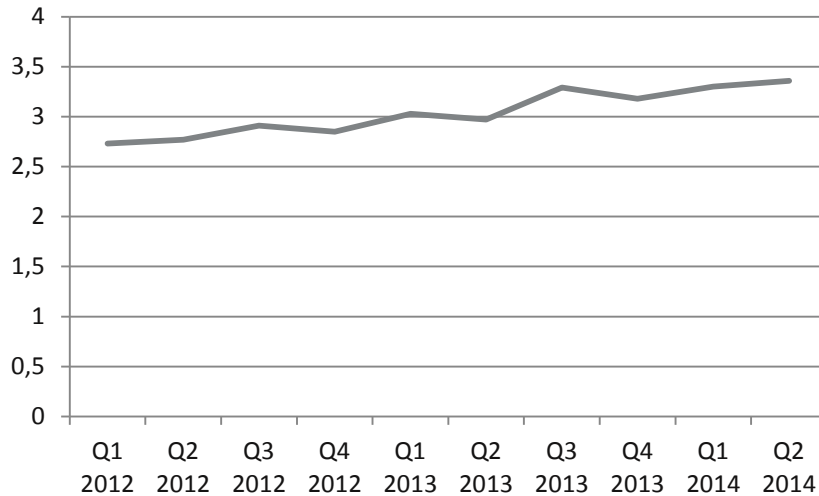
12M forward as of 17-11-2013

# EUR High Yield market

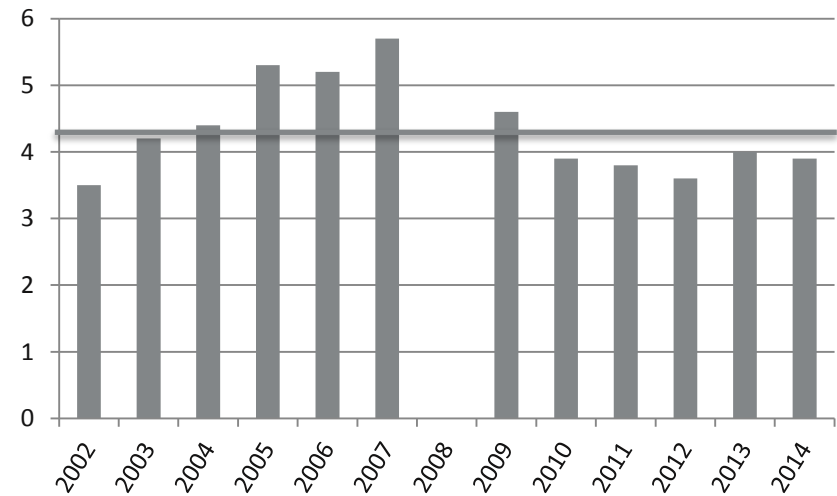


➔ Keep calm and Carry on? Some deterioration in HY Quality

Covenant quality in Europe (Moody's investor service)



European High Yield New issue Leverage (Net debt / EBITDA)

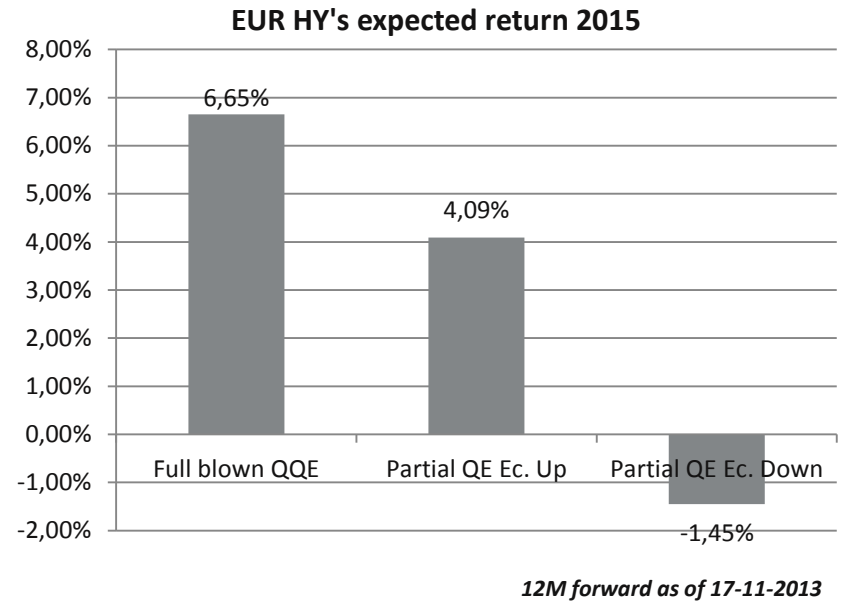
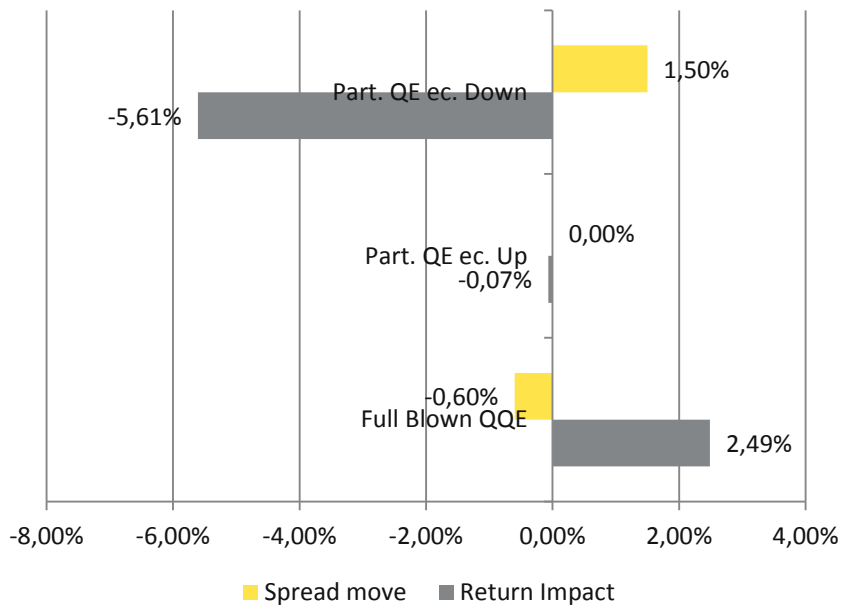


Source J.P. Morgan

*The higher the number, the lower the credit quality*

# EUR High Yield market

## → Total return potential EUR High Yield bond market



## → The Carry (4.05%) provides a cushion, but not in all circumstances

*Spread moves as of 17-11-2013*

# Global Equities

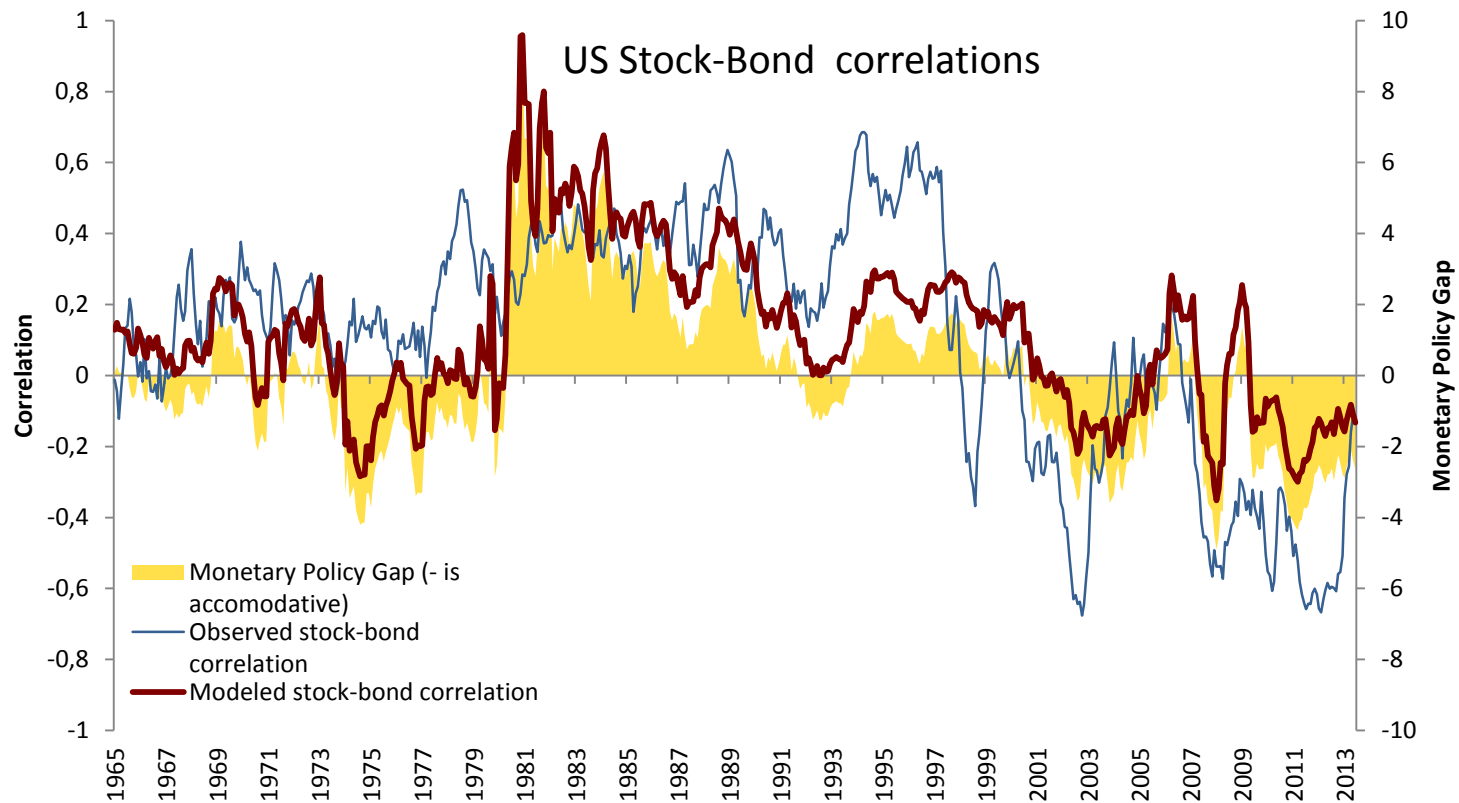
- Tug of war between tighter monetary conditions & higher growth....





# Global Equities

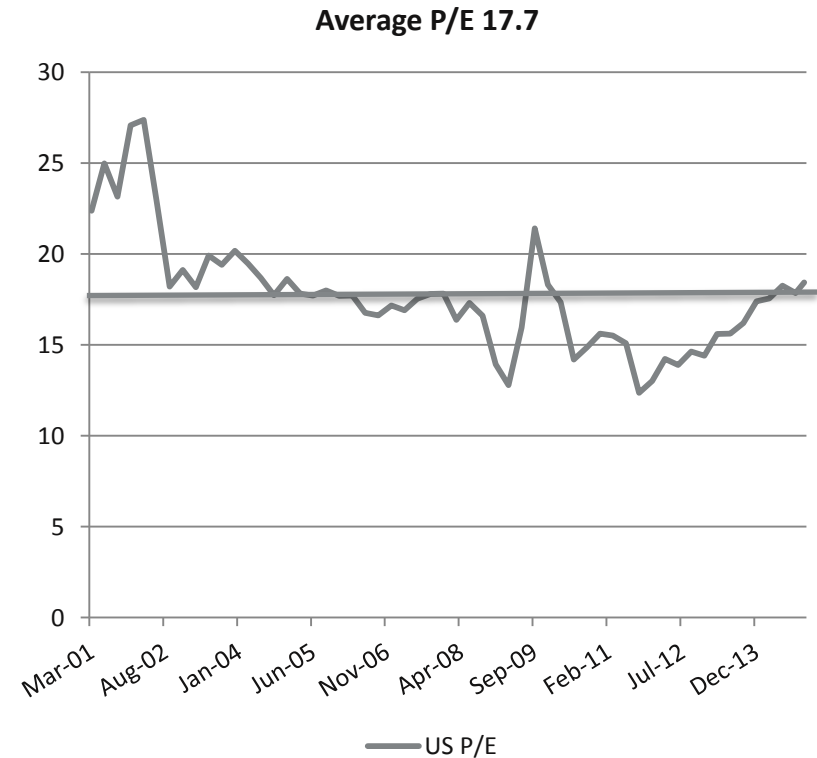
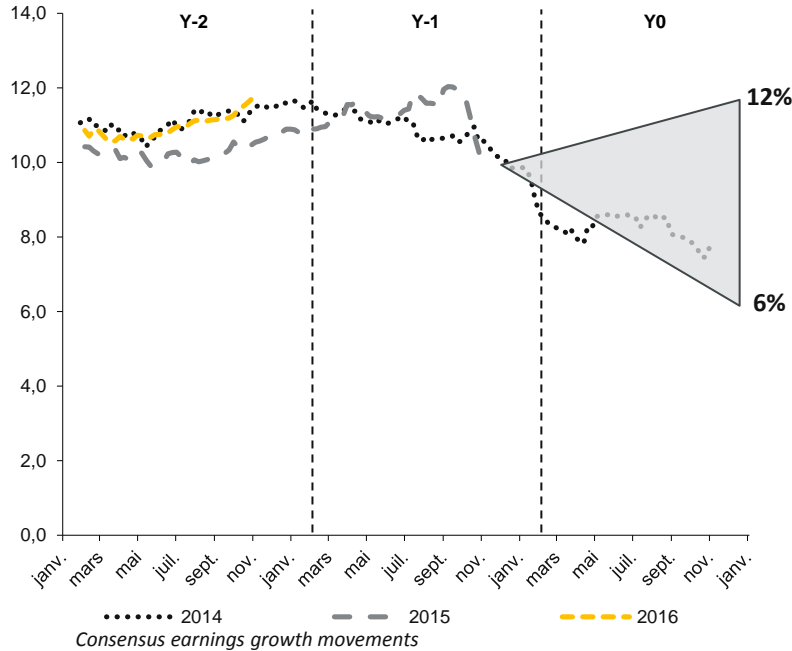
→ And the correlation between bonds & equities in 2015



Source: Petercam analytics

# US Equities

➔ Tug of war between tighter monetary conditions & higher growth



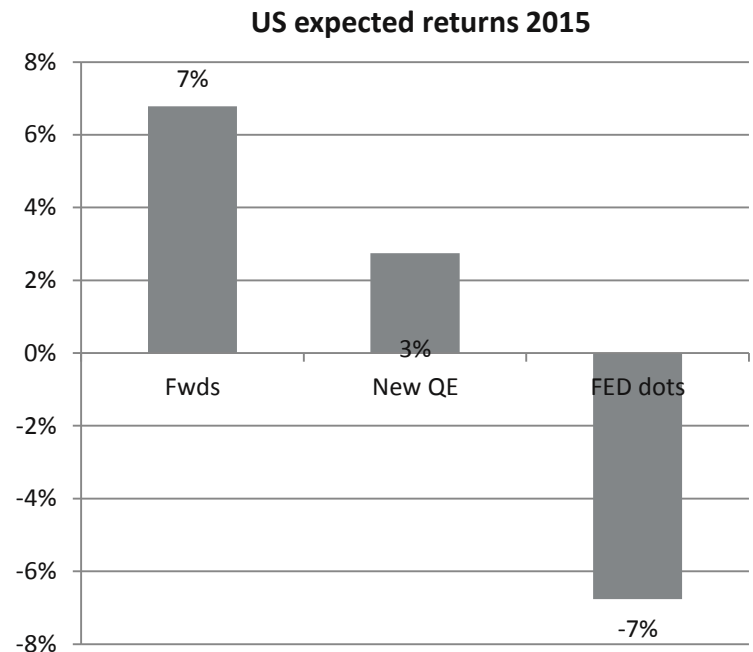
Datastream data as of 15-11-2013

# US Equities

→ Tug of war between tighter monetary conditions & higher growth

- An « all consensus » scenario delivers a positive return for US equities
- If inflation expectations fall and FED re-enters QE (or equivalent), valuations will remain supported by low yields
- If the FED surprises the market, it could de-rail the equity multiple

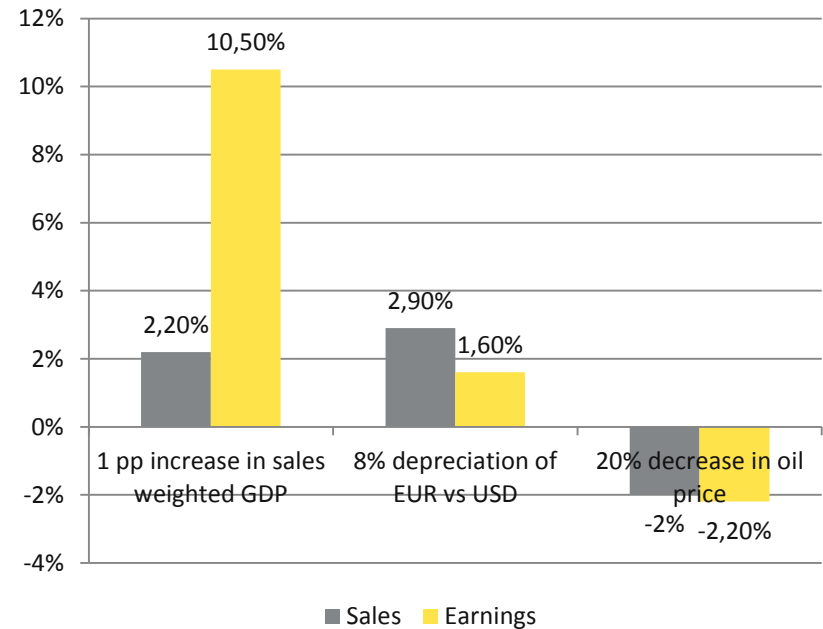
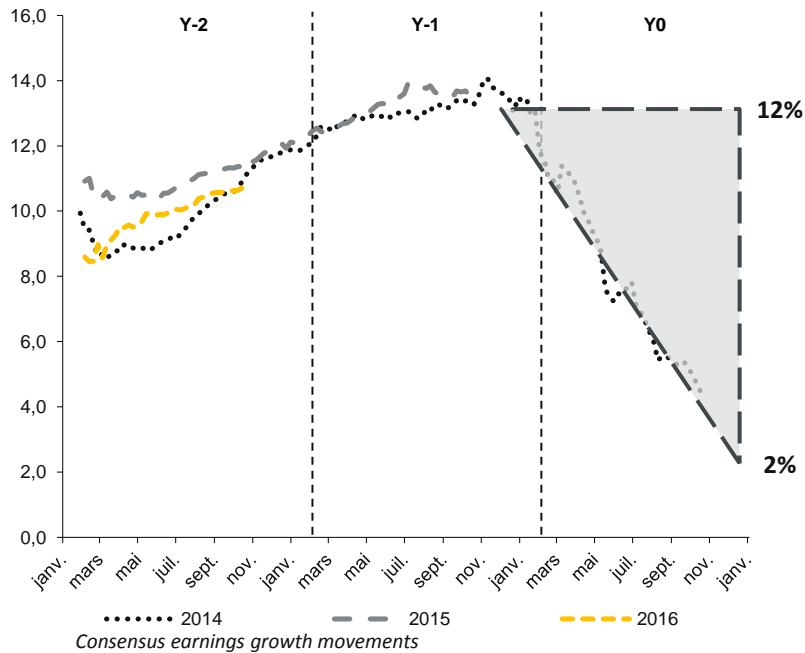
	US	Growth rate E	Multiple	Dividend
2014	Current		18.4	2.03%
2015e	Fwds	9.0%	17.7	1.93%
2015e	New QE	6.0%	17.5	1.93%
2015e	FED dots	12.0%	15	1.93%



12M forward as of 17-11-2014

# European Equities

➔ GDP growth is the earnings driver in Europe



Source: Goldman Sachs Global IR

Datastream data as of 15-11-2013

# European Equities

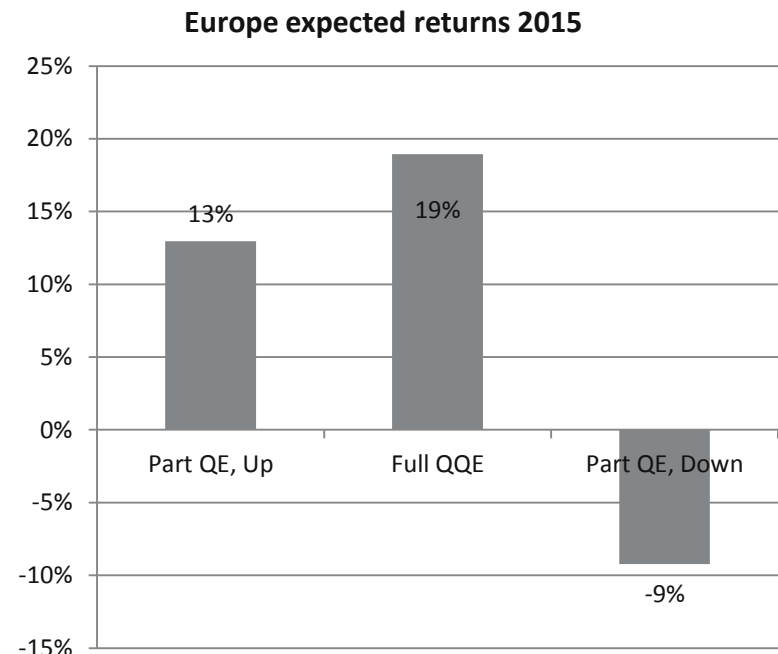
→ Putting a price on earnings growth

→ Partial QE and a higher economic growth will provide decent performance in 2015

→ If the ECB acts and delivers Full QQE, valuations will move towards US (and earnings expected to grow comparable to last year)

→ No additional action and low / no growth means derating and negative returns

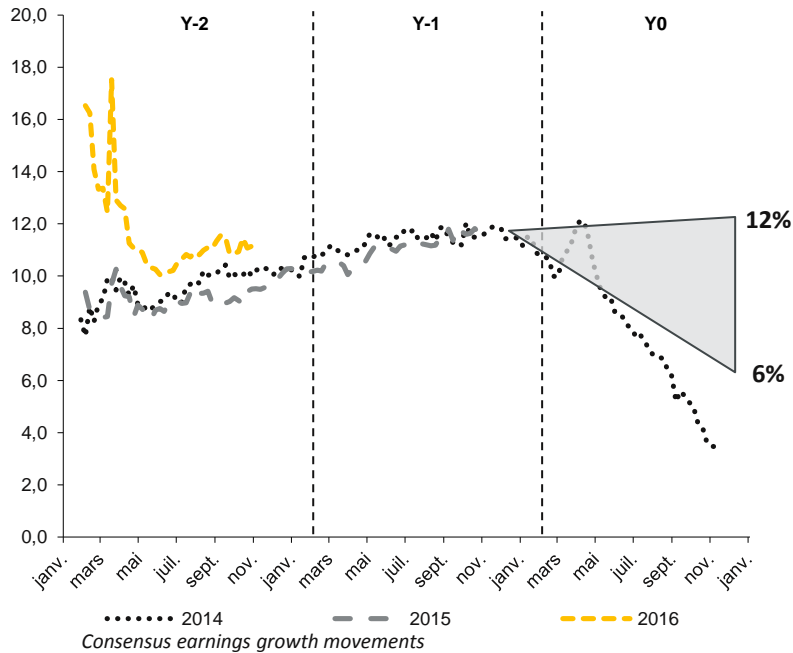
	Europe	Growth rate E	Multiple	Dividend
2014	Current	4%	16.4	3.50%
2015e	Part QE, Up	12.0%	16	3.70%
2015e	Full QQE	5.0%	18	3.70%
2015e	Part QE, Down	2.0%	14	3.70%



12M forward as of 17-11-2014

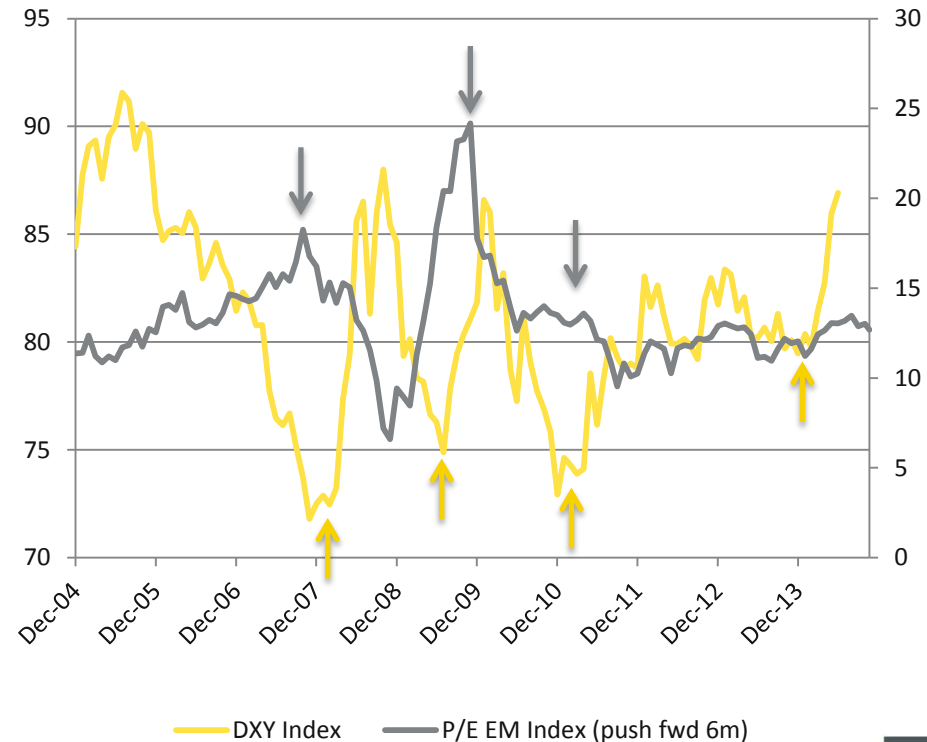
# Emerging Equities

➔ Diverse Universe with different drivers, but stronger USD dampens valuations recovery



Datastream data as of 15-11-2013

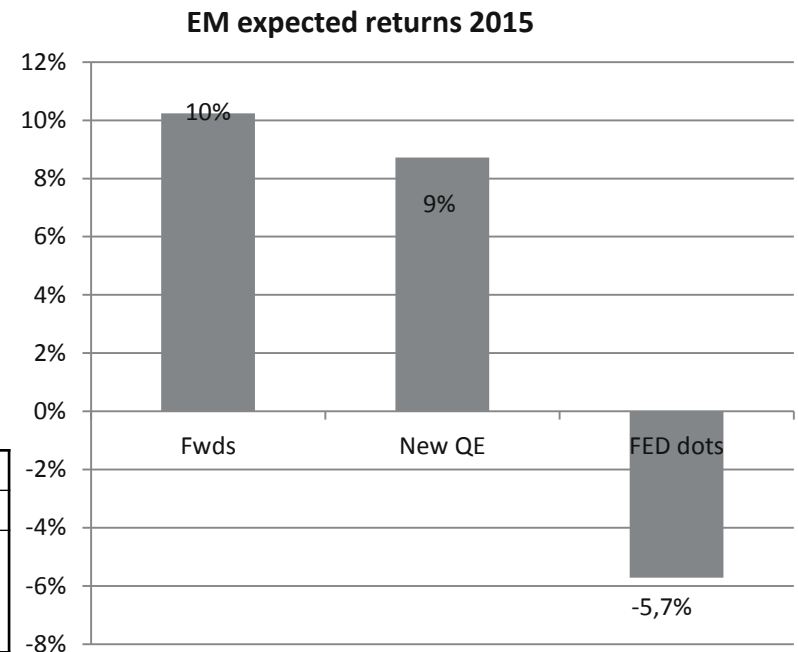
➔ EM valuations sensitive to USD



# Emerging Equities

- FED's fingers on EM valuations
  
- Consensus earnings growth and Forward rates implied interest rate move bodes well for EM Equities
- Should some form of QE in US happen again, USD will fall and this will help EM valuations
- FED can be punitive for EM if acting aggressively

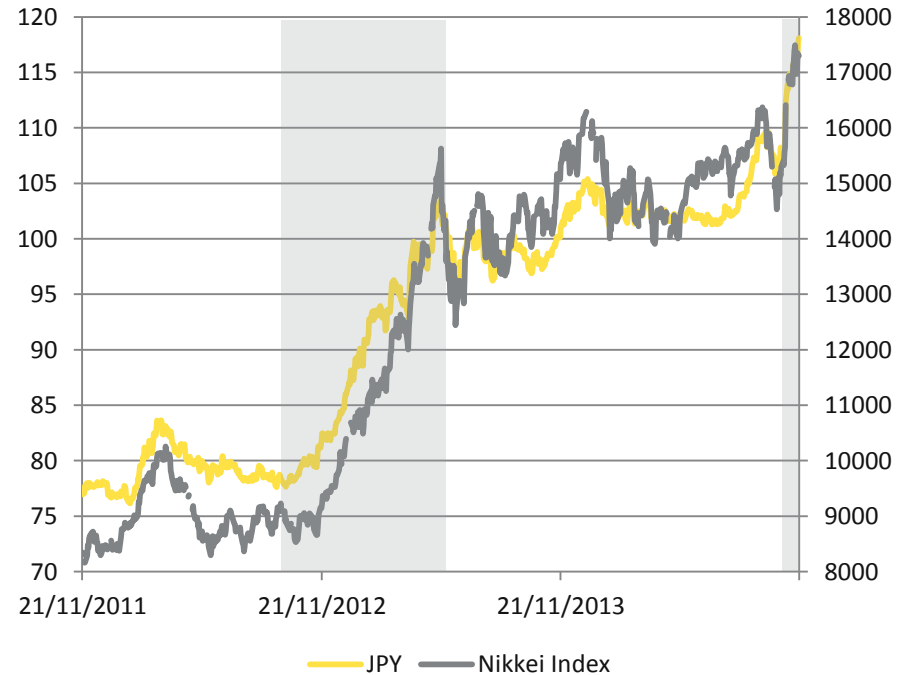
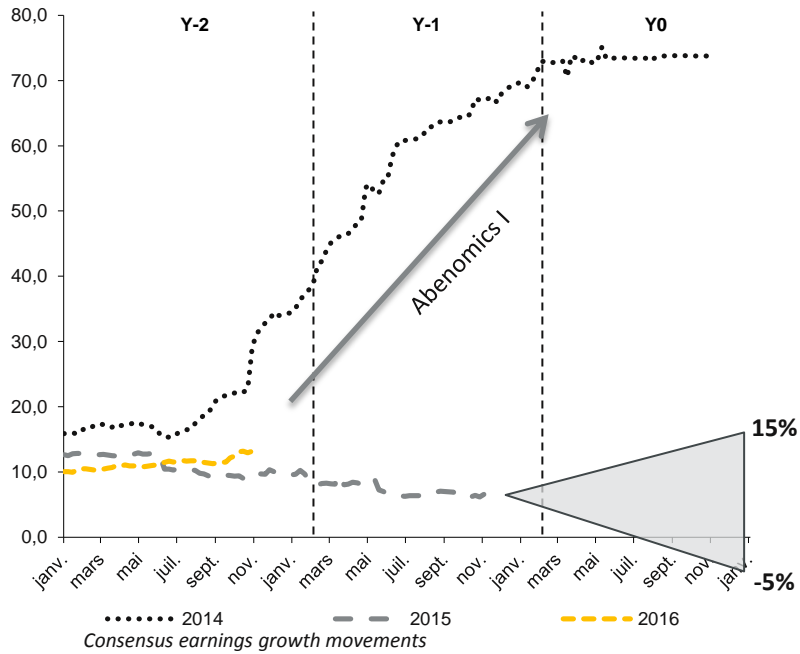
	Emerging Markets	Growth rate E	Multiple	Dividend
2014	<i>Current</i>		12.5	2.83%
2015e	Fwds	12.00%	12	2.72%
2015e	New QE	6.00%	12.5	2.72%
2015e	FED dots	9.00%	10.5	2.72%



12M forward as of 17-11-2014

# Japanese Equities

## ➔ Abenomics Part II?



Datastream data as of 15-11-2013

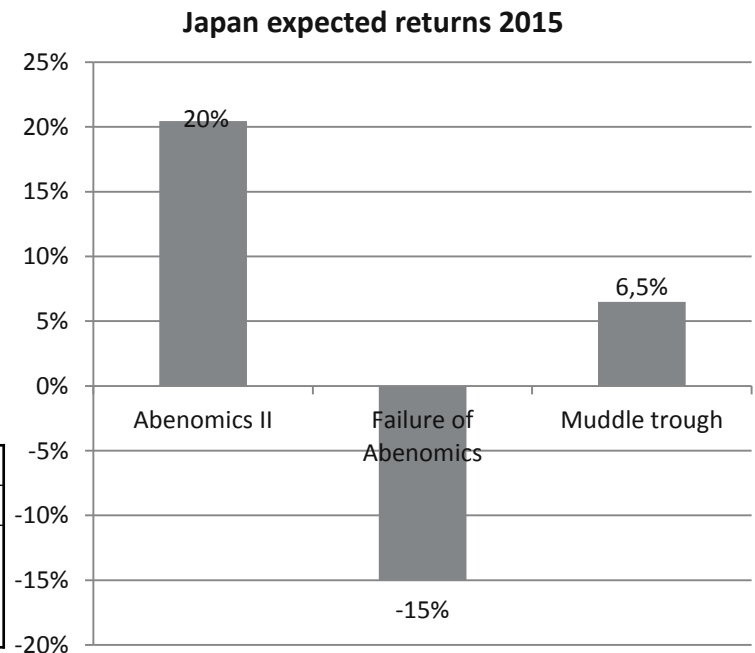


# Japanese Equities

→ Japan is going all in with additional QQE and fiscal stimulus

- Abenomics II is a success and stokes « animal spirits » in Japan
- The experiment fails to generate sustainable inflation and Japan throws in the towel
- Still undecided: JPY weakness helps corporates but does not (yet) translate in anchoring inflation higher

	Japan	Growth rate E	Multiple	Dividend
2014	<i>Current</i>		16	
2015e	Abenomics II	15.00%	16.5	1.87%
2015e	Failure of Abenomics	-5.00%	14	1.87%
2015e	Muddle trough	8.00%	15.5	1.87%



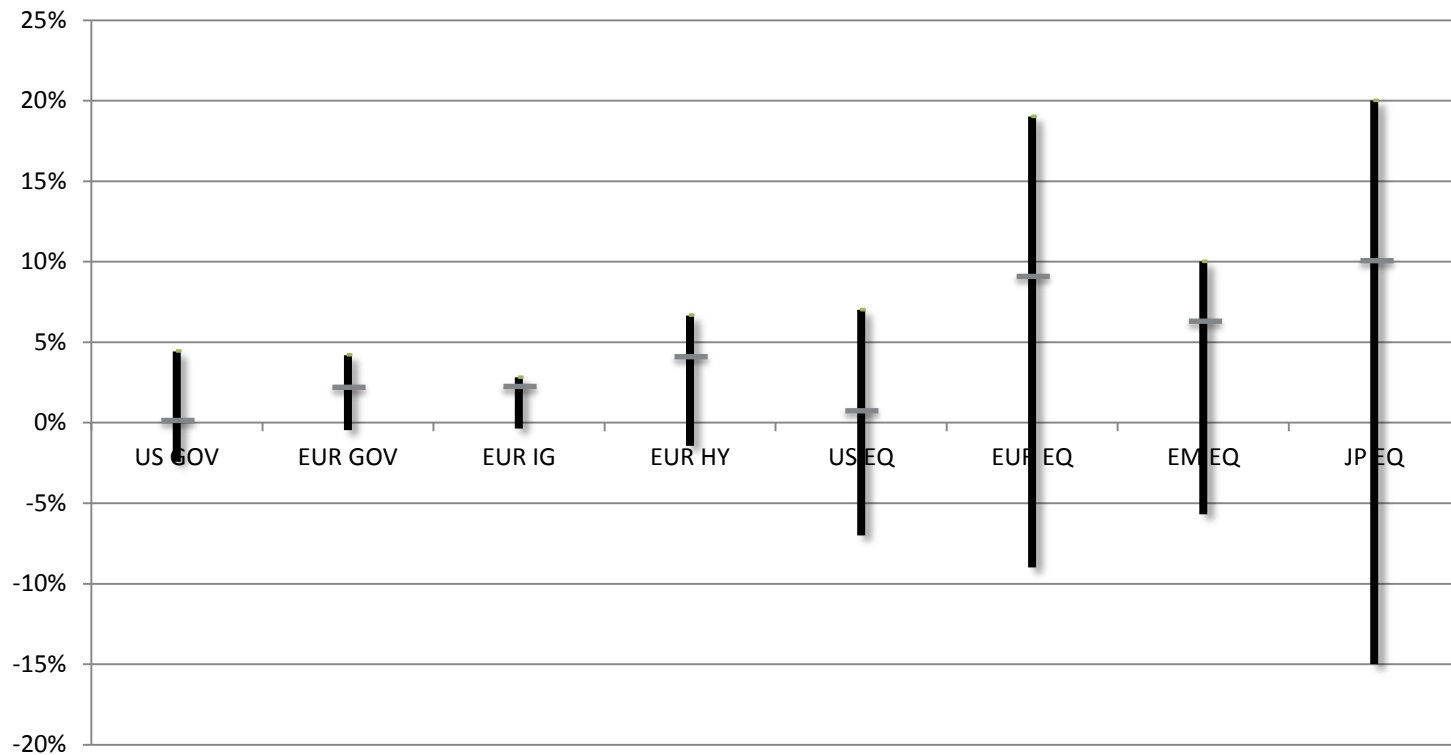
12M forward as of 17-11-2014

# Conclusion

- An aggressive FED is a risk for US treasuries (and equities)
- European rates will stay low for longer
- Credit and High Yield still provide carry
- US equity valuations are at risk
- A bit of growth can make a big difference for European earnings
- EM has to deal with a stronger USD
- The success of *Abenomics part II* (after the election) will drive returns
- **2015 will be a tug of war between potentially tighter monetary conditions & possibly higher growth**

# Conclusion

## → Expected return intervals for 2015



12M forward as of 17-11-2014


# Contact details Sales team


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