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Global Equities and Macroeconomic Review

January 2017

Global Equity Markets Review, January 2017

Encouraging economic data lifts most of the equity markets

Global markets kick-started 2017 on a positive note thanks to the resilient economic performance of most economies across the world. Encouraging corporate earnings season and robust economic data underpinned the healthy performance of US equities as major equity indices hit their record highs. After ending 2016 on a buoyant note, European equities retreated marginally in January. Despite largely encouraging economic data, European equities struggled to post gains as political and trade-related uncertainties dragged the markets lower. Asian equities were largely up in January as robust domestic economic data pushed the markets higher.

Theresa May opens up about Brexit

In January, British PM Theresa May gave a speech charting her plans for Brexit negotiations and clearing some doubts surrounding the UK's future trade relationship with the EU. May affirmed that the UK would not seek membership of the EU's single market but would focus on free trade agreements with European members. In addition, May confirmed her intentions to initiate the Brexit process by the end of March; however, the UK's Supreme Court mandated a parliamentary vote to trigger Article 50.

Fed's cautious approach comforts emerging markets

Federal Reserve Chair Janet Yellen reiterated her view that the Fed would adjust the stance of monetary policy gradually over time. Yellen's comment comforted markets that the Fed would maintain a cautious approach in raising the rate despite the possibility of a direct or indirect fiscal stimulus in Donald Trump's regime. Emerging markets equities rallied in January as the dollar weakened during the month, easing some pressure on emerging market currencies.

Trump's tumultuous first ten days in office

US President Donald Trump dominated the headlines throughout the month, as his inauguration as US President on January 20 followed a flurry of executive orders. He sought to make a strong impression at the start of his term by signing several executive orders in his very first week of Presidency. Fulfilling his campaign promises appeared to have been the key driving force behind the orders, in spite of their contentious nature, and besides the fact that he has hasn't completely assembled his Cabinet. Out of the total 17 orders signed in his first week itself, the key orders were

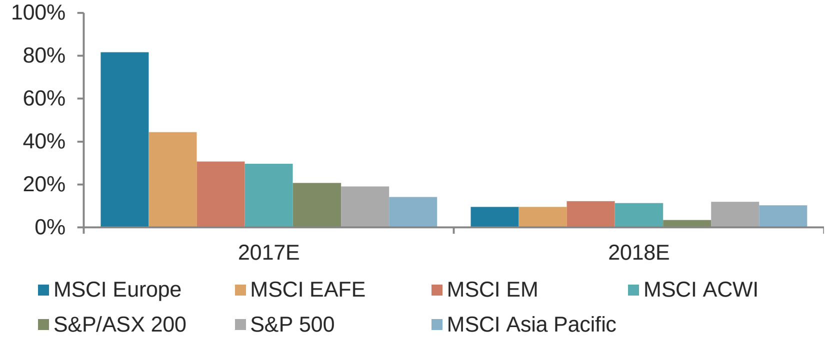
- **Obamacare related:** Trump signed an order stopping or delaying the implementation of aspects of Obamacare that would put any financial or regulatory burden on individuals. The idea of Obamacare being repealed has been one of the mainstays of the Republican party for the past several years.
- **Withdrawal from Trans Pacific Partnership (TPP):** Trump called off Obama's pet trade agreement idea and a key tenet of the Asia pivot, the TPP, which was yet to be ratified by the senate. Trump's administration affirmed its inclination for more favorable bilateral trade deals.

Valuations

The US markets are trading just close to their 10-year high next twelve months (NTM) P/E, thus appearing relatively expensive. However, robust fundamentals such as strong labor market and encouraging corporate earnings season offer strong support for high valuation of US equities. The MSCI EM, an emerging market (EM) index, is trading close to its 10-year average, making it attractive on the valuations front. The emerging markets are still expected to drive the global economy, but the possibility of a trade war and protective policies pose a downside risk for EM equities.

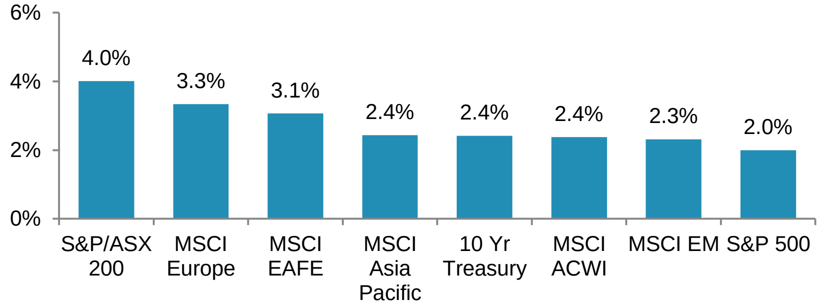
The current dividend yield of ASX 200 and MSCI Europe stood at 4.0% and 3.3%, respectively. In view of the low cash rate of 1.5% offered by the Reserve Bank of Australia (RBA) and near-zero interest rates in Europe, equity markets in these regions offer relatively attractive returns to conservative investors.

Exhibit 1: Global Earnings Growth Forecast



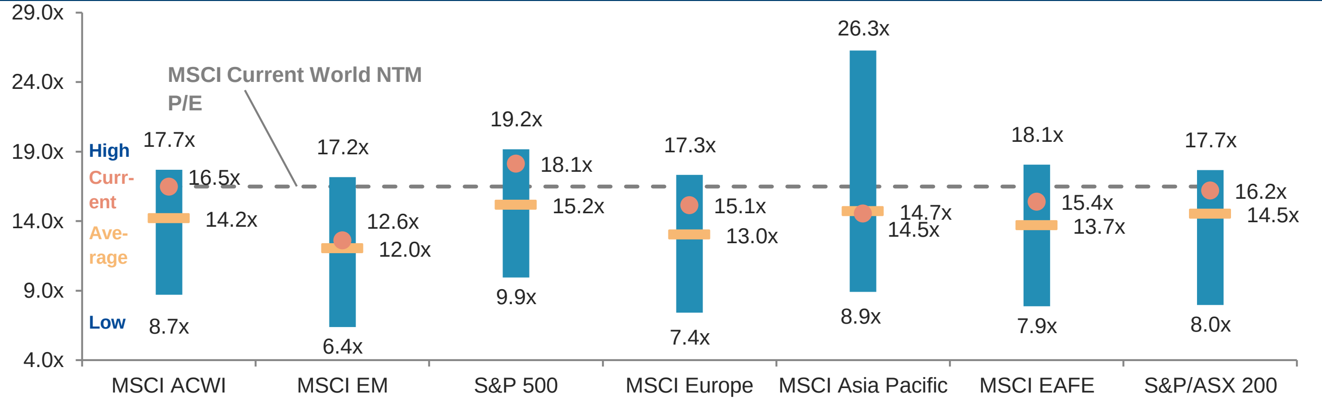
Source: *Bloomberg; Note: EAFE and ACWI stand for Europe, Australasia and Far East and All Country World Index, respectively; S&P/ ASX 200 represents the Australian Securities Exchange*

Exhibit 2: Current Dividend Yield



Source: *Bloomberg*

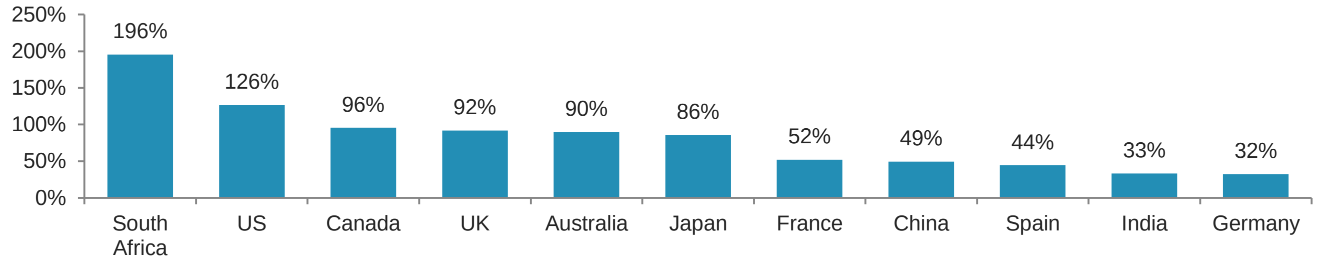
Exhibit 3: Current NTM P/E vs. 10-Year High, Low, Average



Source: *Bloomberg; Note: NTM P/E stands for next twelve months price-to-earnings; All charts are updated as on February 20, 2017*

The market capitalization-to-GDP ratio, also known as the Buffett indicator, is one of the single best measures of where the valuations stand at any given moment when seen in conjunction with fundamentals of the economy. Typically, a reading above 100 indicates market is overvalued and reading below 50 indicates markets are undervalued. The Buffett indicator, as shown in exhibit 4, suggests that India and China are relatively undervalued, indicating opportunity for value investors amid robust economic performance. Australia's market capitalization-to-GDP ratio of 90% also indicates potential for growth. Meanwhile, the US appears overvalued. In fact, the Buffett indicator for the US is as high as that before the stock market crash in 2000, pointing to an impending correction in the markets.

Exhibit 4: Market Capitalization to GDP



Source: *Bloomberg, Reuters Eikon*

Exhibit 5: Global Equity Markets' Characteristics

	S&P 500	MSCI EAFE	MSCI ACWI	MSCI EM	MSCI Europe	MSCI Asia Pacific	S&P/ ASX 200
Number of Holdings	505	928	2,484	832	446	1,023	200
Market Capitalization (USD Trillion)	21.0	16.3	48.5	8.3	9.4	12.0	1.7
Dividend Yield (%)	2.0	3.1	2.4	2.3	3.4	2.4	4.0
NTM P/E (x)	18.1	15.4	16.5	12.6	15.1	14.6	16.2
Price to Book (x)	3.1	1.6	2.2	1.6	1.8	1.5	2.0
Price to Cash Flow (x)	13.0	6.9	9.5	7.3	7.1	7.0	12.7
Price to Sales (x)	2.1	1.2	1.6	1.3	1.2	1.1	2.2

Source: *Bloomberg*

Exhibit 6: Equity Market Total Return Analysis (%) Across Asset Classes

	2010	2011	2012	2013	2014	2015	2016	Jan-17
Higher	Small Cap 26.81	Growth 2.64	Emerging Markets 18.62	Small Cap 38.82	S&P 500 13.68	Growth 5.67	Small Cap 21.28	Emerging Markets 5.47
	Mid Cap 25.43	S&P 500 2.11	International 17.96	Mid Cap 34.82	Value 13.45	S&P 500 1.37	Value 17.33	Growth 3.37
	Emerging Markets 19.24	Value 0.39	Value 17.51	Growth 33.49	Mid Cap 13.21	International -0.28	Mid Cap 13.78	International 2.91
	Growth 16.70	Mid Cap -1.55	Mid Cap 17.30	Value 32.56	Growth 13.05	Global -1.80	S&P 500 11.95	Global 2.76
	Value 15.50	Small Cap -4.18	Global 16.82	S&P 500 32.37	Small Cap 4.90	Mid Cap -2.44	Emerging Markets 11.50	Mid Cap 2.41
	S&P 500 15.06	Global -6.84	Small Cap 16.39	Global 23.49	Global 4.75	Value -3.84	Global 8.51	S&P 500 1.90
	Global 13.28	International -11.68	S&P 500 15.99	International 23.44	Emerging Markets -1.97	Small Cap -4.41	Growth 7.07	Value 0.71
Lower	International 8.34	Emerging Markets -18.16	Growth 15.26	Emerging Markets -2.26	International -4.32	Emerging Markets -14.61	International 1.59	Small Cap 0.39

Source: *Bloomberg; Note: Small Cap is represented by Russell 2000 Index; Emerging Markets is represented by MSCI Emerging Markets Index; Value is represented by Russell 1000 Value Index; Mid Cap is represented by Russell Midcap Index; Global is represented by MSCI ACWI Index; Growth is represented by Russell 1000 Growth Index; International is represented by MSCI EAFE Index; Note: All charts are updated as on January 31, 2017*

Australia

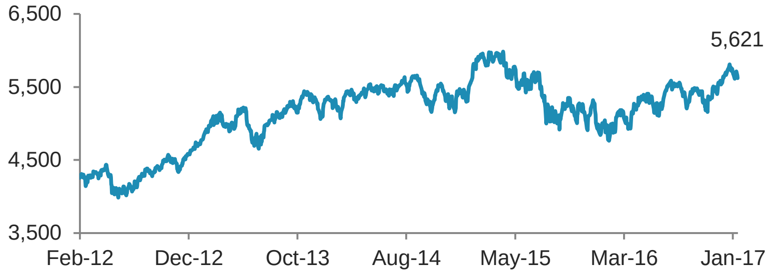
The Australian Securities Exchange (ASX 200) declined 0.8% in January 2017, following a gain of 4.1% in December 2016, primarily due to the financial sector's underperformance. Only four of the 11 sectors ended in the green; the Healthcare and Materials sectors were the top performers in January.

Compared to global currencies, the AUD rallied 5.2% against the USD over the month. Moreover, the AUD appreciated against Australia's major trading allies (CNY - 4.2%, EUR - 2.7%, JPY - 1.6% and KRW - 0.4%).

Key Investment Themes:

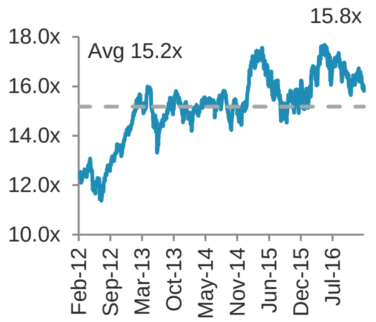
- **Market continues to rely heavily on resources support:** The recovery in commodity prices, especially copper (8.2%) and iron ore (5.7%), dominated the Australian market. This rebound would be transformed into improved earnings for resource industry players. The Mining and Metals sector was the best performer in January 2017 due to increased commodity prices. Australian Energy stocks performed reasonably well. The Australian market underperformed, primarily due to weakness in other sectors such as Banks, despite the mining sector's strong performance. As softness in the financial sector drove lower market returns in January, the Australian equity market continues to rely heavily on support from resources for higher returns in 2017.
- **Economic data suggests improvement in business conditions:** The NAB survey of business conditions for December rose after a series of month-over-month declines. The index rallied to 11.4 from 5.7. The unemployment rate declined to 5.7% from 5.8% in the previous month. However, the value of retail sales for December decreased 0.1% m/m.

Exhibit 7: S&P/ASX 200 Performance



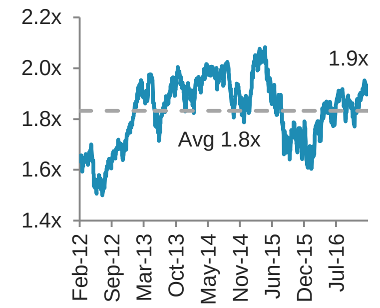
Source: *Bloomberg*

Exhibit 8: NTM P/B



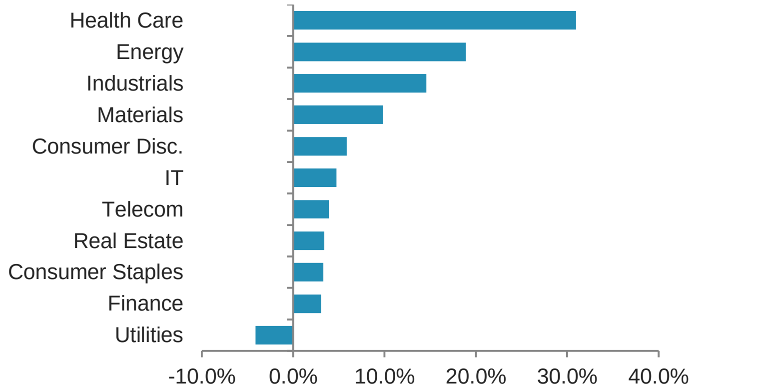
Source: *Bloomberg*

Exhibit 9: NTM P/B



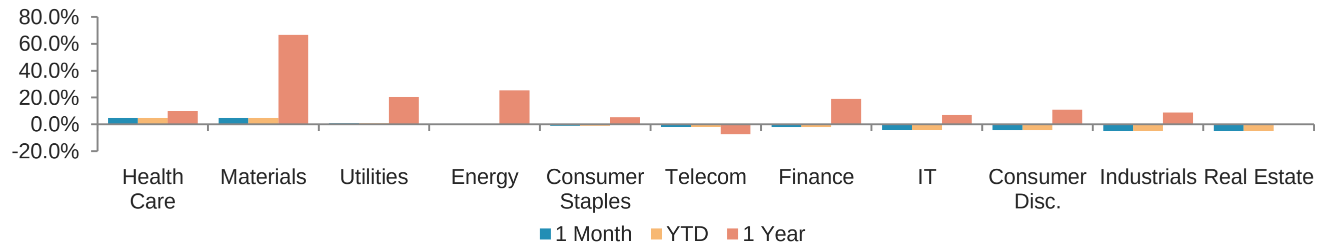
Source: *Bloomberg*

Exhibit 10: Estimated 3–5 Yrs. Earnings Growth



Source: *Bloomberg*

Exhibit 11: Sector-wise S&P/ASX 200 Performance



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

US

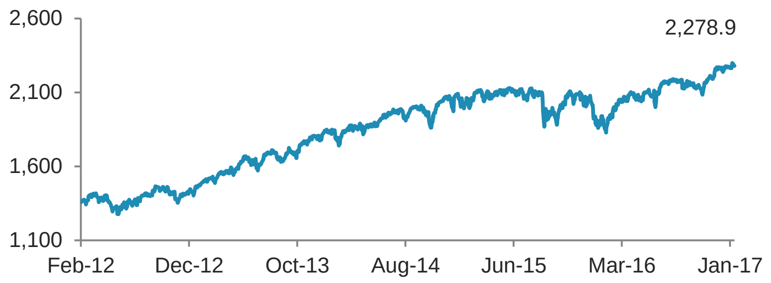
The S&P 500 was up 1.8% in January 2017, a third consecutive monthly gain, as investors remain buoyed by possible changes to the US corporate tax code and the regulatory environment. However, the market remains volatile due to delay or disruption caused by the policy changes. The market performance was also driven by strong economic data released during the month. Core retail sales increased 0.3% in January, while the core consumer price index rallied 0.6% during the month. The sustained job creation in recent months appears to be translating into strong consumption in the US.

The Federal Reserve avoided over aggression in its interest-rate-normalization campaign. Fortunately, the market anticipates no more than two Fed rate hikes in 2017.

Key Investment Themes:

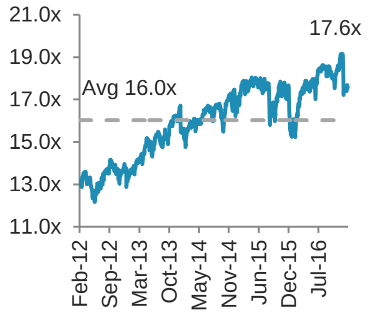
- **Financial services sector gains momentum:** The improved economic data and growing expectations of the Fed raising the interest rates quicker rather than later would boost the financial services sector to strong returns. This will be profitable to especially banks, gaining higher interest margins as short-term rates increase.
- **Tax reform to boost consumer companies:** Companies operating in the US are likely to benefit the most from the corporate tax reform. Meanwhile, companies with large international operations are at the greatest risk of seeing their tax bills increase. Consumer staples companies, media companies, restaurants and domestic retailers are likely to see neutral or positive impact from changing policy dynamics. We believe automakers and suppliers, apparel and footwear manufacturers, and discount retailers are likely to be negatively impacted.

Exhibit 12: S&P 500 Performance



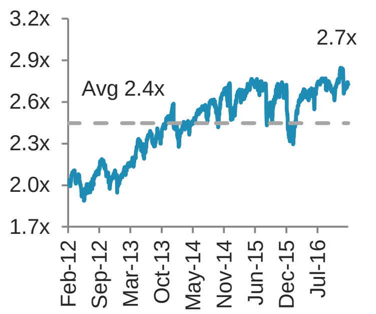
Source: *Bloomberg*

Exhibit 13: NTM P/E



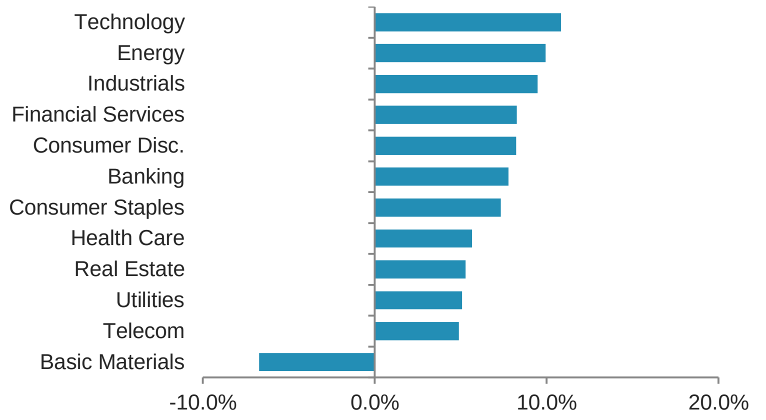
Source: *Bloomberg*

Exhibit 14: NTM P/B



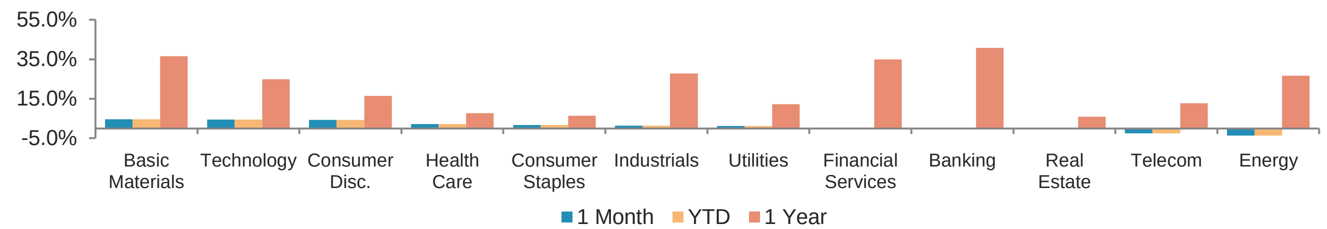
Source: *Bloomberg*

Exhibit 15: Estimated 3–5 Yrs. Earnings Growth



Source: *Bloomberg*

Exhibit 16: Sector-wise S&P 500 Performance



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

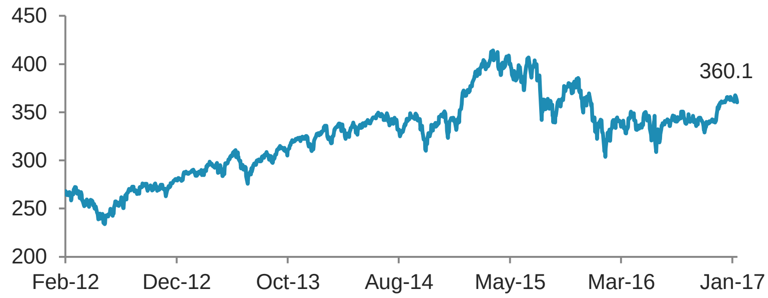
Europe and the UK

Stoxx Europe 600 declined marginally by 0.4%, as the market struggled to build on the momentum it had enjoyed at the end of 2016. Energy was the weakest sector, followed by real estate. Information technology was the only sector to register a positive return. On a country basis, Italian stocks were weakest, while Germany and Spain outperformed.

Key Investment Themes:

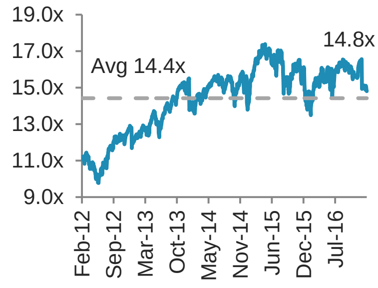
- **Eurozone inflation picks up:** Economic data in Europe was largely positive during the month. The latest employment numbers reported the fastest growth rate since 2009. Inflation was 1.8% in January 2017 compared with 1.1% in December 2016, the highest since February 2013, driven by rising energy and food prices. Meanwhile, Germany expanded at its fastest pace in five years following an increase in private consumption, higher wages, less unemployment, and large exports. As per Destatis, the German economy expanded 1.9% in 2016.
- **More clarity on Brexit:** The UK Supreme Court declared that the parliament must pass a legislation to trigger Article 50 of the Lisbon Treaty to leave the EU. Moreover, the UK's Prime Minister Theresa May confirmed that Britain would not remain a partial member of the EU single market.
- **Global uncertainty weighs on economic growth:** The European Commission believes that for the countries sharing the euro, growth would slow a bit to 1.6% in 2017 from 1.7% in 2016. The uncertainty of upcoming elections in Germany and France, the ongoing implications of Brexit, and the direction of US policies are factors likely to weigh on growth

Exhibit 17: STOXX Europe 600 Performance



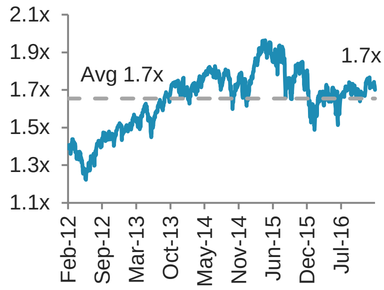
Source: *Bloomberg*

Exhibit 18: NTM P/E



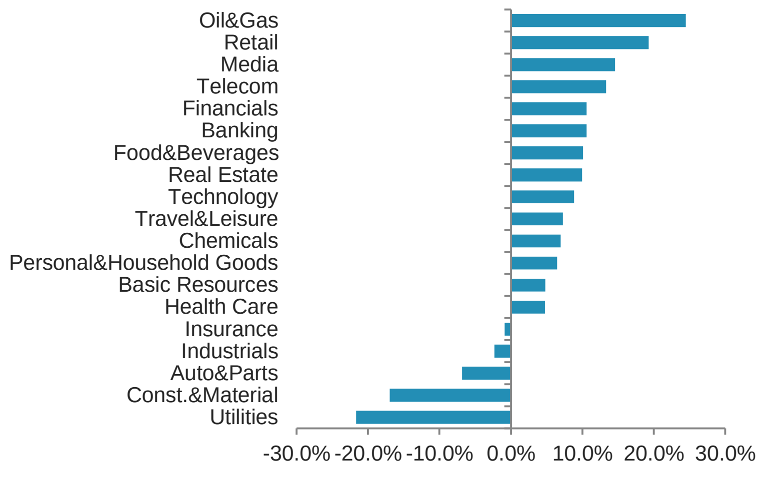
Source: *Bloomberg*

Exhibit 19: NTM P/B



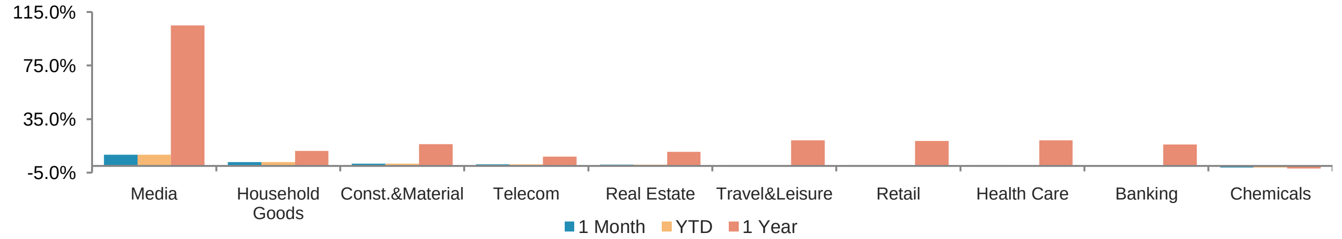
Source: *Bloomberg*

Exhibit 20: Estimated 3–5 Yrs. Earnings Growth



Source: *Bloomberg*

Exhibit 21: Sector-wise STOXX Europe 600 Performance (Top 10 Sectors)



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

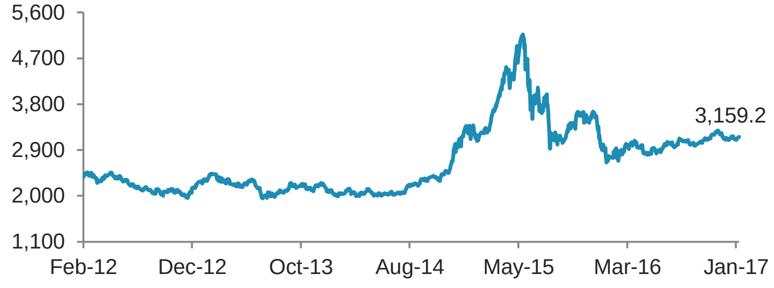
China

Driven by robust consumer spending, higher government expenditure and healthy bank lending, the Chinese economy advanced 6.8% y/y in 4Q16, beyond the market expectation of 6.7% y/y. Full-year GDP growth stood at 6.7% in 2016, with consumption contributing 65% of this growth. Buoyed by positive economic data, investors continued to push Chinese equities higher as the Shanghai Composite Index rose 1.8% in January. Robust performance by property-sector stocks lifted Hong Kong's stock markets as Hang Seng index gained 6.2% in January.

Key Investment Themes:

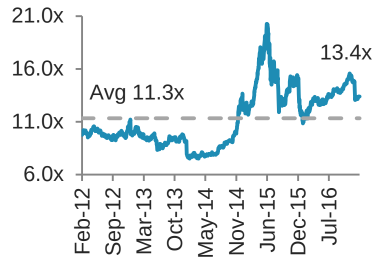
- **China launches Internet investment fund to boost Internet sector:** In January, the Cyberspace Administration of China and Ministry of Finance launched a 100 billion yuan (US$ 14.6 billion) Internet investment fund to support companies operating in Internet-related sectors. The government has already raised 30 billion yuan from state-owned banks and enterprises. The ICBC, along with China Development Bank, will provide financial services and 150 billion yuan of credit to enterprises that have attracted investment from the fund.
- **Machine and electronics export surge in January:** China's export swelled 15.9% y/y in January, as foreign trade with the European Union and the United States jumped 14.1% and 21.9%, respectively. Export of machinery and electronics grew 16.6% y/y, accounting for 56.1% of total export volume in January. In view of scope for improvement in economic activities in Europe and US in near future, China's well established export focused companies would be key area of possible investment opportunity.

Exhibit 22: Shanghai Stock Exchange Performance



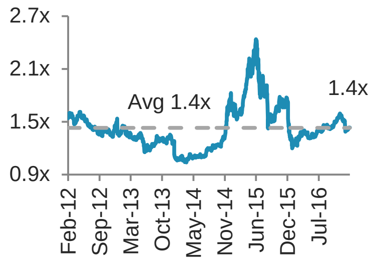
Source: *Bloomberg*

Exhibit 23: NTM P/E



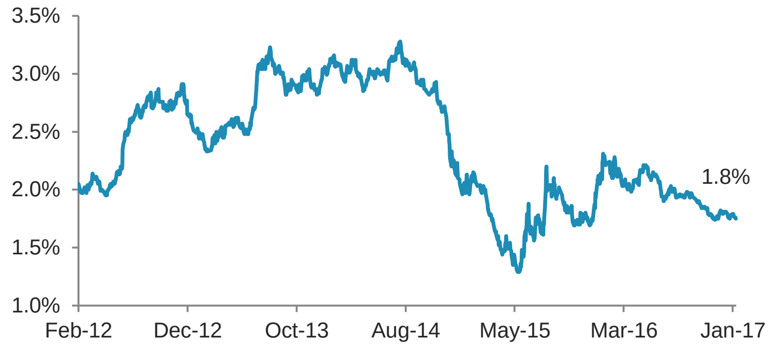
Source: *Bloomberg*

Exhibit 24: NTM P/B



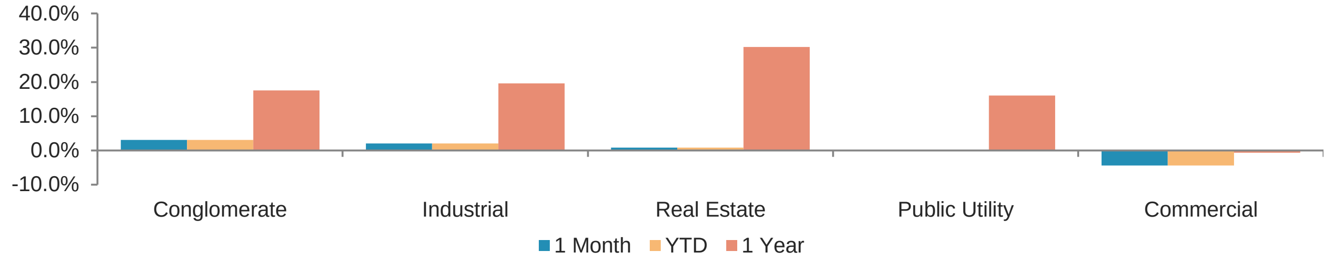
Source: *Bloomberg*

Exhibit 25: Dividend Yield



Source: *Bloomberg*

Exhibit 26: Sector-wise Shanghai Stock Exchange Performance



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

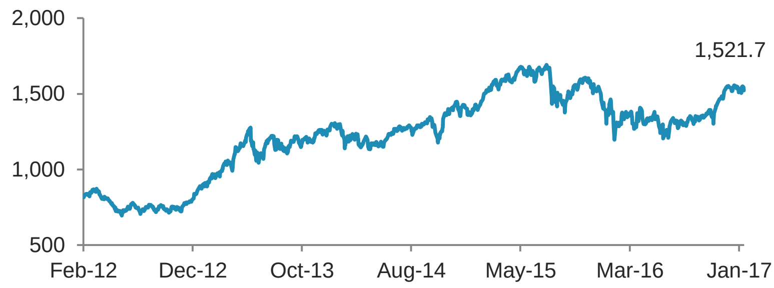
Japan

In February, Japanese equities moved sideways during the month of January, as Japanese equities recorded marginal gains during the month. TOPIX gained 0.2% in January as strengthening yen affected investor sentiments. The marine transportation sector outperformed the broader market, while defensive sectors such as foods and pharmaceuticals had a disappointing run. Investors continued to favor economically sensitive sectors such as metals and retail on account of encouraging economic data and prospects of higher growth in the future.

Key Investment Themes:

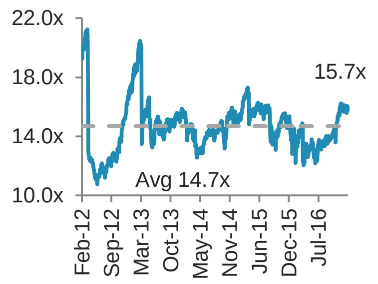
- **Exporters to benefit from weaker yen:** The strengthening of the US dollar, following Trump's victory in the US presidential election in November, resulted in a weaker yen. Japanese export-focused companies are lifting their annual profit guidance for the fiscal year through March 2017 on account of lower yen outlook.
- **Marine transportation sector looks attractive:** The marine transportation industry's operating earnings per share over the next full business cycle are estimated to outperform the broader market. The TOPIX marine transportation index gained 18.5% since the Japanese trio of Nippon Yusen K.K. (NYK Line), Mitsui O.S.K. Lines, and Kawasaki Kisen Kaisha opted to merge their container business on 31st of October. The index could add more gains as business sentiment continues to recover.

Exhibit 27: TOPIX Performance



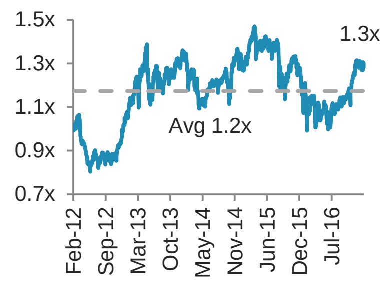
Source: *Bloomberg*

Exhibit 28: NTM P/E



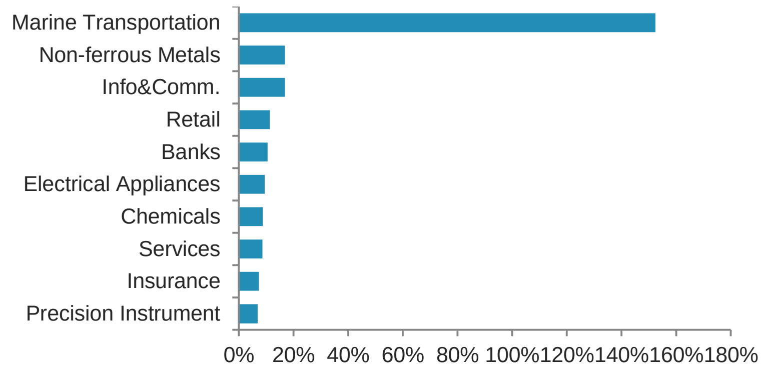
Source: *Bloomberg*

Exhibit 29: NTM P/B



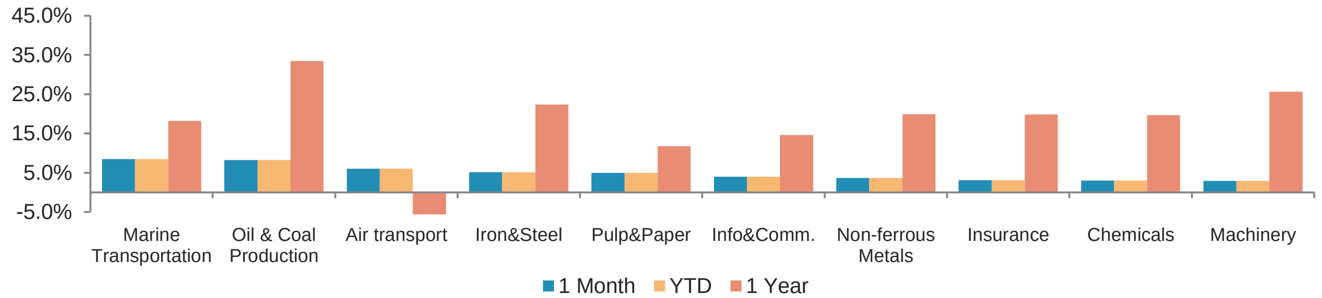
Source: *Bloomberg*

Exhibit 30: Estimated 3–5 Yrs. Earnings Growth (Top 10 Sectors)



Source: *Bloomberg*

Exhibit 31: Sector-wise TOPIX Performance (Top 10 Sectors)



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

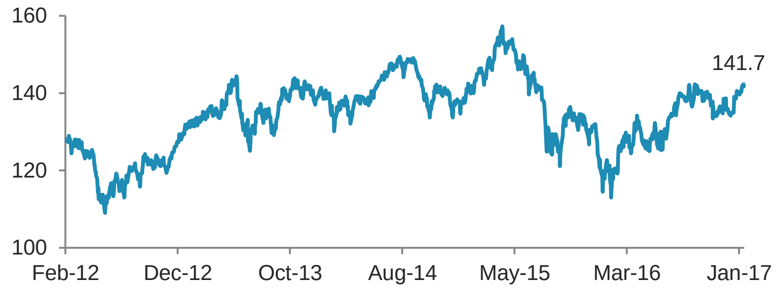
Asia

Strengthened by region-specific factors, Asian markets outperformed their developed market peers in January. Indian equity markets witnessed a pre-budget rally, which was further supported by encouraging corporate earnings. South Korean equities moved northward on account of strong performance by the technology sector. Better-than-expected GDP data uplifted stock markets in the Philippines, while Indonesian equities finished flat. The MSCI Asia Pacific index jumped 4.9% during January, supported by weakness in the US dollar.

Key Investment Themes:

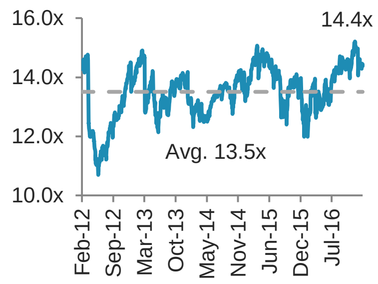
- **India's affordable housing and housing finance sector to benefit from budgetary provisions:** On February 1, the Indian government presented a substantive and fiscally prudent budget. Budgetary announcements offered an impetus to the affordable housing industry and housing finance companies. Affordable housing projects will get "infrastructure" status, thereby entitling them with benefits such as tax concessions and lower cost of borrowing. This is expected to eventually reduce the cost of construction, which when passed on to customers will increase demand for such houses, benefiting both realtors and housing finance companies.
- **Increasing demand for South Korean commercial property to benefit real estate sector:** In 2016, foreign investors invested around US$ 12 billion in South Korea's commercial properties, up 15% as compared to the previous year. South Korean commercial properties remain attractive due to comparatively lower prices, high investment yield, and low volatility.

Exhibit 32: MSCI Asia Pacific Index Performance



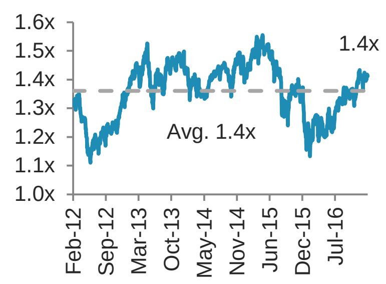
Source: *Bloomberg*

Exhibit 33: NTM P/E



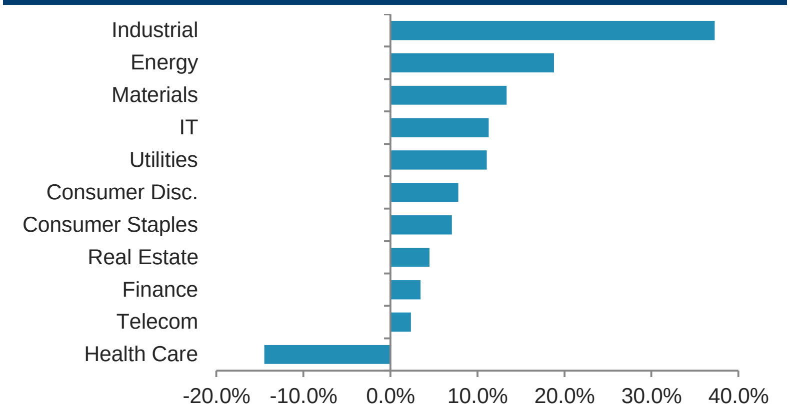
Source: *Bloomberg*

Exhibit 34: NTM P/B



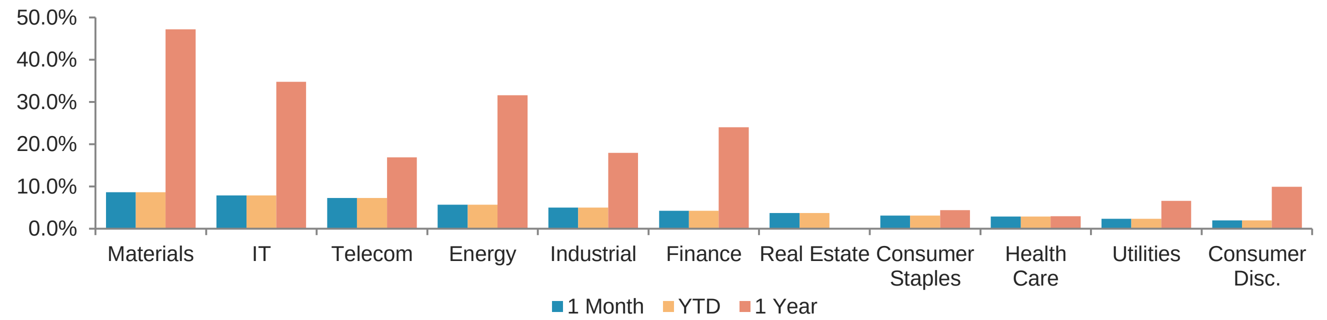
Source: *Bloomberg*

Exhibit 35: Estimated 3–5 Yrs. Earnings Growth



Source: *Bloomberg*

Exhibit 36: Sector-wise MSCI Asia Pacific Index Performance



Source: *Bloomberg; Note: Top 10 sectors selected based on past month performance; All charts are updated as of January 31, 2017*

Glossary

Index	Description
MSCI ACWI (All Country World Index)	A free float-adjusted market capitalization index that is designed to measure equity performance of 23 Developed Markets (DM) and 23 Emerging Markets (EM) countries. DM countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the US. EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. With 2,468 constituents, the index covers approximately 85% of the global investable equity opportunity set.
MSCI Asia Pacific	A free float-adjusted market capitalization index that is designed to measure equity performance of 5 DM countries (Australia, Hong Kong, Japan, New Zealand and Singapore) and 8 EM countries (China, India, Indonesia, Korea, Malaysia, the Philippines, Taiwan and Thailand) in the Asia Pacific region. With 1,019 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
MSCI EAFE (Europe, Australasia, Far East)	A free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US and Canada. The EAFE consists of the country indices of 21 developed nations.
MSCI Emerging Markets	A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of June 2, 2014, the index consists of the following 23 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey, and the United Arab Emirates.
MSCI Europe	A free float-adjusted market capitalization index that is designed to measure equity performance of 15 DM countries in Europe (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK). With 446 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.
Russell 2000	Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 1000 Value Index	Measures the performance of those Russell 1000 companies with higher price-to-book ratios and lower forecasted growth values.
Russell Mid-cap	Measures the performance of the 800 smallest companies of the Russell 1000 Index, which represent approximately 30% of the total market capitalization of the Russell 1000 Index.
Russell 1000 Growth Index	Measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
Shanghai Stock Exchange (SSE)	Capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.
Standard & Poor's 500 (S&P 500)	Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. Represents approximately 68% of the investable US equity market.
Stoxx Europe 600 (Stoxx)	Measures changes in stock market conditions based on the average performance of 600 widely held common stocks across 17 countries of the European region: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. Represents approximately 88% of the investable European equity market.
S&P/ASX 200	Measures changes in stock market conditions based on the average performance of 200 largest index-eligible stocks listed on the Australian Securities Exchange (ASX).
TOPIX (Tokyo Stock Price Index)	Capitalization-weighted index that tracks the daily price performance of all companies listed on the First Section of Tokyo Stock Exchange.

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