# Investment Strategy

Quarterly views

## Margin of safety

- **The outlook for the global economy remains mixed**. US growth is broadening but not accelerating, Japan is picking up after last year's brief recession, and the eurozone has begun to recover. Emerging economies are a mixed bag: India has improved, China continues its adjustment to a slower growth model, while Brazil and Russia face recession.
- With the exception of certain commodity-dependent emerging economies, **global inflationary pressures are muted**.
- **Monetary policy divergence will increase** as we get closer to the first rate hike from the Fed and the ECB embarks on its quantitative easing. Globally however, policy settings will remain extremely accommodative.
- The shift in Fed policy will put some upward pressure on US Treasury yields, but any increase should be capped by the impact of declining yields and tightening spreads in the eurozone. **Euro-denominated high-yield** and selected **hard currency emerging bond markets** (especially dollar-denominated bonds) continue to **offer some value** in comparison.
- The **dollar**, after a steep rally, **has now completed the bulk of the adjustment we expected** against the euro. There is a risk of further downside in the euro in the short run, but we do not believe that it will last.
- **Global equity valuations have increased markedly** in recent years. The environment of non-inflationary growth, low yields and easing monetary policies will continue to **push investors towards equities**, although there is a risk of correction after such a sustained move. We upgrade our rating on the eurozone to Neutral. Our preferred markets remain in Asia-Pacific.
- As consumer confidence recovers, the **global consumer is an attractive investment theme** for equity investment.
- We are **Neutral on oil prices**, but we see continued **downside in gold**. Within hedge funds, we continue to prefer market-neutral equity strategies.
- **Global financial markets look expensive**, especially in light of the mixed outlook for growth. Policy settings are however supportive, and we continue to favour diversification across our preferred markets and themes.

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# Editorial

**"Confronted with a [...] challenge to distill the secret of sound investing into three words, we venture the motto, MARGIN OF SAFETY".**
*Benjamin Graham, The Intelligent Investor, 1949.*

As widely expected, the European Central Bank (ECB) finally launched its version of quantitative easing in early March 2015. This historic decision by the Governing Council, in the face of stern opposition from the Bundesbank and certain other national central banks, can be viewed as a diplomatic triumph for ECB President Mario Draghi. However, we do not believe that investors should see it as a panacea for the eurozone's economic ills.

This is in part because of the time it took to build a consensus within the Governing Council. Since Draghi's promise in July 2012 to do "whatever it takes" to preserve the integrity of the eurozone, sovereign bond yields have tumbled to historic lows and deflation fears have become entrenched. As much of the intended impact on bond prices has already been achieved, the ECB finds itself attempting to buy bonds with negative or negligible nominal yields. In addition, a number of the major holders of eurozone sovereign bonds (such as pension funds, commercial banks or insurance companies) may prove reluctant to sell their holdings because of regulatory or asset/liability matching constraints. The combination of these factors is likely to squeeze yields lower across the board, but with limited direct impact on economic growth given the weakness of credit transmission within the banking system. Beyond weakening the currency and temporarily making imports more expensive, it is far from clear how this can help revive long-term inflation expectations within the eurozone.

As a result, investors face a dilemma. On one hand, the asset purchase programme will push prices higher and pull credit spreads lower, which will rapidly shrink any margin of safety in these bonds. On the other, the ECB's open-ended commitment is designed to force investors to take on more risk in terms of duration or credit exposure.

Turning to other markets, we find similar dynamics at play. Divergences in monetary policy settings are having a profound influence on foreign exchange markets. Since the US Federal Reserve confirmed in July 2014 that it would halt asset purchases that October, the US dollar has experienced one of the sharpest rallies in recent decades: the dollar index has advanced by some 25% with barely a pause.

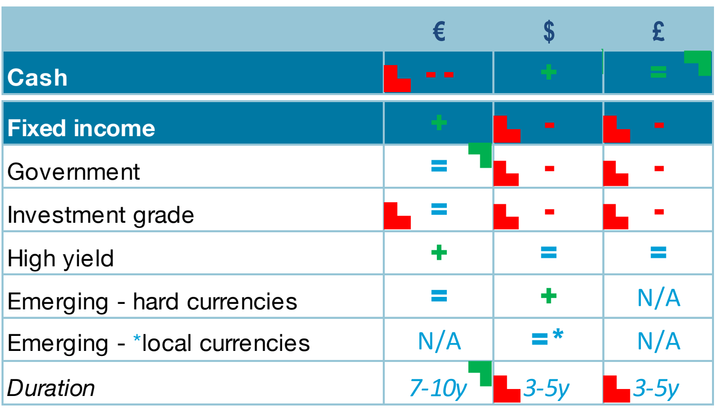
This has in turn had a marked impact on equity markets, with eurozone stocks for example outperforming their advanced economy peers in local currency terms. But this is a type of "money illusion" – measured in a weakening euro, investors feel wealthier; measured in a strengthening dollar however, year-to-date performance is barely positive. In addition, valuation indicators (price-to-earnings ratios) have continued to stretch ever higher, reducing the margin of safety available to investors. Since Draghi's speech in 2012, eurozone equities have risen more than 60% in price terms. This can however be broken down into a 10% decline in trailing earnings and an increase of over 70% in valuations.

Of course, none of this indicates that a correction is imminent - indeed, prices and valuations could move higher still in the short term. But it does reinforce the need for careful diversification across our preferred markets, sectors and themes in order to build robust portfolios in light of the slim margins of safety on offer.

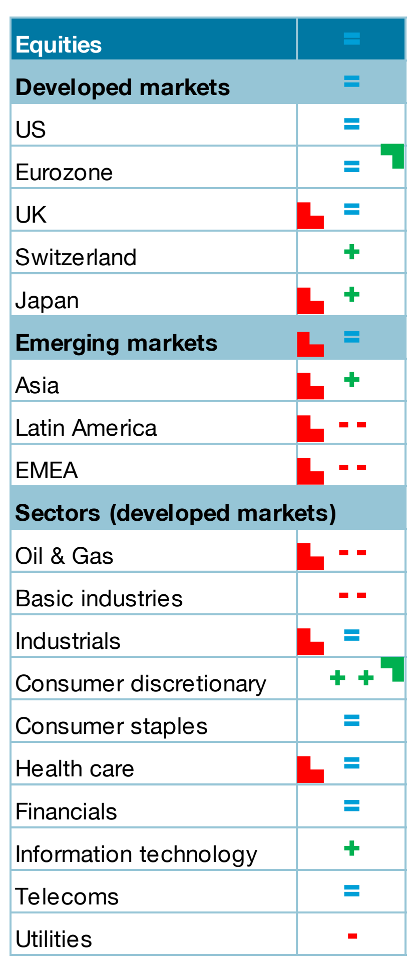
*Margin of safety:* the difference between an asset's intrinsic value and its market price
*Price to earnings ratio (P/E):* share price divided by earnings per share.

# Asset class convictions

## Investment time horizon 6-12 months



| | € | $ | £ |
|---|---|---|---|
| **Cash** | - - | + | = |
| **Fixed income** | + | - | - |
| Government | = | - | - |
| Investment grade | = | - | - |
| High yield | + | = | = |
| Emerging - hard currencies | = | + | N/A |
| Emerging - *local currencies | N/A | =* | N/A |
| *Duration* | *7-10y* | *3-5y* | *3-5y* |



| Equities | = |
|---|---|
| **Developed markets** | = |
| US | = |
| Eurozone | = |
| UK | = |
| Switzerland | + |
| Japan | + |
| **Emerging markets** | = |
| Asia | + |
| Latin America | - - |
| EMEA | - - |
| **Sectors (developed markets)** | |
| Oil & Gas | - - |
| Basic industries | - - |
| Industrials | = |
| Consumer discretionary | + + |
| Consumer staples | = |
| Health care | = |
| Financials | = |
| Information technology | + |
| Telecoms | = |
| Utilities | - |

| Currencies | vs USD | vs EUR | vs GBP |
|---|---|---|---|
| USD | N/A | = | = |
| EUR | = | N/A | = |
| GBP | = | = | N/A |
| CHF | = | = | = |
| JPY | - | - | - |
| Emerging | = | = | = |

| Alternatives | |
|---|---|
| **Commodities** | - |
| Oil | = |
| Gold | - |
| **Hedge funds** | = |

Upgrade since previous publication

Downgrade since previous publication

| Gradings | Allocation (vs benchmark) | Absolute expectations (vs cash) | Relative expectations (vs history) |
|---|---|---|---|
| + + | Strong overweight | Capital gain | Capital gain |
| + | Overweight | Capital appreciation | Above average return |
| = | Neutral | Yield return* | Average return |
| - | Underweight | Cash return | Below average return |
| - - | Strong underweight | Capital loss | Capital loss |

*Yield return: Money market rate for FX, coupon yield for bonds, dividend yield for stocks

**Tactical investment allocations and weightings may differ from these Strategic asset class convictions and are subject to change on an ongoing basis. They may not be exactly as shown. Investors should understand the different asset classes which make up the strategy, as they have different risk characteristics.**

# Fixed Income

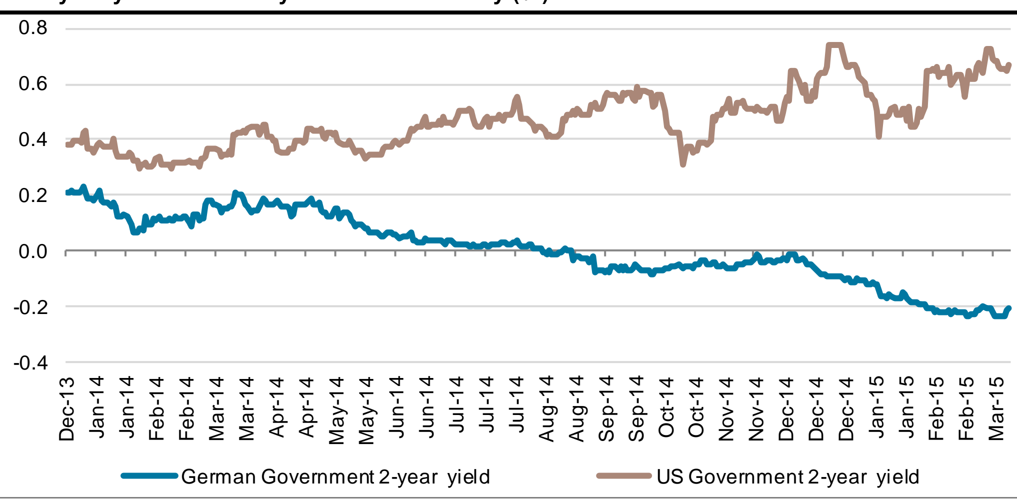
## Rates: US and eurozone on diverging paths

**Diverging trends in monetary policies are increasing the US Treasuries-Bund yield differential.**

2015 will likely see further divergence in monetary policies between the United States and the eurozone. The European Central Bank (ECB) is embarking on a more accommodative monetary policy through new quantitative measures mainly targeting government bond purchases. Meanwhile, the Federal Reserve (Fed) will begin to hike rates before the end of the year. These diverging trends will have different impacts on the future path of interest rates in the two regions.

In the eurozone, out of a total €60billion (bn) monthly purchase programme announced by the ECB, which is expected to last at least until September 2016, €50bn will target government, agency and supranational bonds. The majority of bond purchases will be carried out by the member countries' national central banks and will mainly concern their own sovereign and agency debt. A smaller share will be implemented directly by the ECB. The figures announced were substantial and surprised market expectations on the upside. For example, Germany, under the ECB's rules, will have to buy around €11.8bn of bonds every month, which means €118bn between March and December 2015. This amounts to 80% of the German government's estimated total gross issuance (new issuance without subtracting bonds reaching maturity) for 2015. The significant additional demand resulting from the ECB's measures will maintain downward pressure on all eurozone yields (when yields fall, prices rise), although the percentage of purchases relative to bond issuance is different for each country.

**Two-year yield to maturity – US and Germany (%)**




Sources: Societe Generale Private Banking, Bloomberg. Data as at 16/03/2015.

*Core* eurozone countries in this context include Germany, France, the Netherlands and Belgium. *Peripheral* eurozone countries include Spain, Greece, Ireland, Portugal and Italy.

A *yield curve* plots bond yields against their respective maturities.

Such pressures will keep short and intermediate core yields in negative territory and will further flatten yield curves, with already low long-term yields decreasing more than short-term yields. At the same time, we expect risk premia on peripheral countries (apart from Greece) to decrease further. Long-term core and peripheral bonds will benefit the most in this context, and we increase durations on both segments.

In the US, the Fed will continue to prepare the ground for a first rate hike this year. Although some market participants forecast a first move in June, we think that the Fed will be more patient and wait until September at least, when the impact of the oil price decline on headline inflation will fade and wage pressures will be more evident on the back of tighter labour

markets. The impact of monetary policy tightening will be felt across US government bond yields in advance, and against this backdrop we would adopt a cautious approach on US rates markets by reducing duration levels. Short to intermediate maturities (between 3 and 5 years) are less sensitive than 10-year rates to changes in interest rates – which is a positive in a context of rising rates, while at the same time offering the best risk/return profile. However, we still believe that yield increases will be capped, as investors will continue to buy US government bonds in a context of accommodative monetary policies globally and low rates in the euro area and Japan.

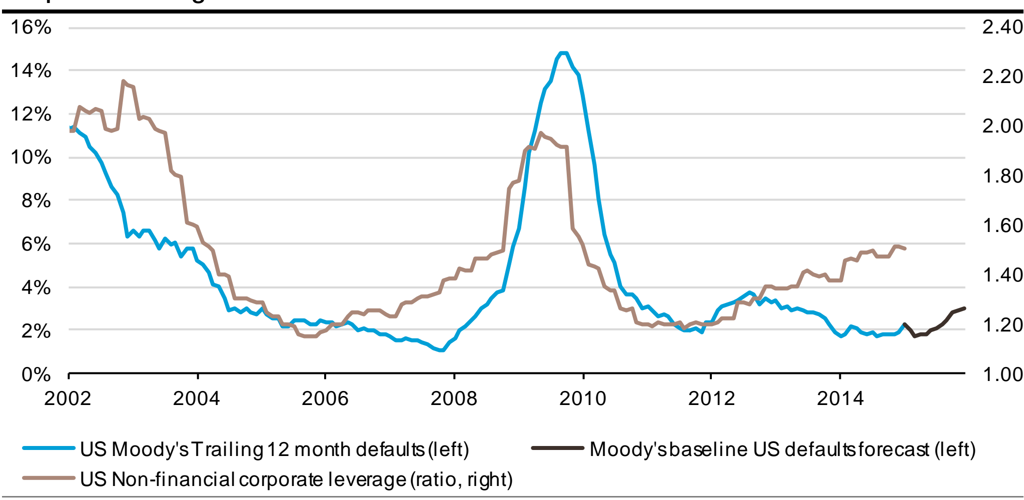
In the UK we expect a similar pattern to the US, with Gilts strongly correlated to US Treasuries. UK growth will be supported by domestic demand, while the decrease in the inflation rate should reverse later in the year for the same reasons as in the United States. The Bank of England seems to be in even less of a hurry than the Fed to normalise rates, and we expect a first rate hike to occur between the end of 2015 and early 2016.

## Credit: getting tougher

**We turn more cautious on investment grade but maintain our positive stance on eurozone high yield.**

US credit fundamentals are gradually deteriorating and underlying interest rates are expected to increase. At the same time, in the eurozone overall yields are very low. Credit markets are getting harder to handle...

Corporate leverage and defaults in the United States



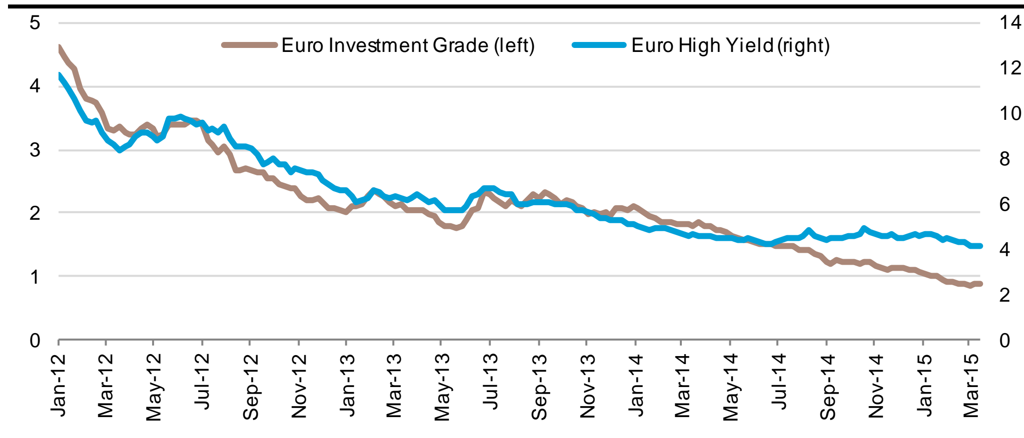

Sources: Societe Generale Private Banking, Moody's, Datastream. Data as at 16/03/2015.

In the US, where economic activity is expected to remain relatively sustained this year, the gradual deterioration in credit fundamentals continues, though we do not expect a sudden marked worsening. On the one hand, companies entered this phase of the credit cycle with healthy balance sheets, so corporate operations such as mergers and acquisitions (M&A) could be partially financed by the cash accumulated in recent years. At the same time, easy financing conditions hitherto have allowed companies to lower their funding costs. On the other hand, however, leverage (by which we mean the ratio of debt to revenue) is growing in a context where net debt is gradually increasing on the back of this higher corporate activity (M&A, share buybacks, dividends), while profit growth remains only moderately positive. Also, at the same time, defaults seem to have bottomed out. The current phase in the credit cycle does not call for a strong sell-off, but these fundamental factors are not likely to provide support for spread compression.

At the same time, however, demand should help the asset class, as investors worldwide will continue to search for higher-yielding products. US credit offers higher yield than European counterparts, for example. What will differentiate the Investment Grade (IG) and High Yield (HY) segments will be the relative impact of rising underlying rates. For IG - where the spread component represents slightly more than a third of the overall yield - rising Treasury yields will weigh on future returns, and we suggest caution on this segment. For HY, where the spread component represents roughly three quarters of the overall yield, we have a more balanced view, and within this segment we prefer non-energy related sectors.

In the eurozone, the low-growth environment will likely prevent the appearance of over-aggressive corporate behaviour (releveraging etc). However, the decline in underlying rates has already dragged credit yields down.

**Euro investment-grade and High Yield (yield in %)**




Sources: Societe Generale Private Banking, Bloomberg. Data as at 16/03/2015.

Following the announcement and implementation of the ECB's government bond purchase programme, downward pressures have extended to corporate bond yields as investors try to earn positive returns in a negative interest rate environment. Against this backdrop, the IG segment has already posted an impressive 7.5% performance over the past 12 months, leaving overall yields at 0.84% (at 15 March 2015). With such a low starting point, IG offers limited value going forward. We prefer the HY segment in the rather credit-friendly European environment. We would also increase duration.

**Past performance is not an indicator of future performance.**

# Emerging debt: Chasing value

**Despite the expected increase in US yields, there are still pockets of value within robust EM economies.**

Emerging debt is back in the spotlight: some countries have built up significant leverage through the bond markets over the past few years, with local bond issuance soaring to meet investors' appetite for yield. Although the USD liquidity environment will become more restrictive this year with the expected Fed tightening, we still consider that there is some value to capture in emerging markets against a backdrop of low yields in developed markets - though careful monitoring is warranted.

First of all, the flattening of yield curves due in developed fixed income markets should maintain appetite for high-yield fixed income products, even in more speculative markets. The run-up in emerging market leverage has been fuelled by fast-rising corporate debt issuance more than by new sovereign debt, which has been funded by local-currency debt markets more than by issuance in hard currencies. As emerging currencies could continue to experience volatility through 2015, we would prefer exposure to hard-currency debt.

Second, the spread widening that occurred at the turn of 2014 and in 2015 for USD-denominated emerging debt, lifting sovereign spreads and raising corporate spreads back to their 2012 levels, has not yet been corrected and so may offer a good entry point. Although we anticipate a pickup of around 50bp in USD long-term yields by the end of 2015, we consider there is room for spread compression (between the underlying USD yields and emerging debt yields) to mitigate its impact. Although retail investors have steadily cut their exposure to emerging debt since the 2013 sell-off, institutional investors have held on to their positions, signalling their ongoing interest for this asset class.

Country risk is set to be the key discriminating factor, and we prefer commodity importers to commodity exporters, as well as countries benefiting from US and global trade expansion and which have room to cut rates on the back of tepid inflation. Sound external positions and a solid local investor base are also necessary to avoid funding pressure stemming from current account deficits or significant capital outflows in light of the increase in US yields. From a country perspective, Indonesia and China's offshore bond market as well as some Central American countries (e.g. Mexico) are worth some attention. The latter are benefiting from improving terms of trade as net commodity importers, and from rising US demand and higher remittances. Corporate debt offers higher yields but also requires thorough examination, as USD liquidity is set to shrink and some issuers look highly indebted.

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**Prospective investors should be aware that they are exposed to the credit risk of the fixed income issuer throughout the term of the investment product and that if the issuer were to default, for example by becoming insolvent or failing to pay the redemption amount on the maturity date, then investors may receive back nothing, or an amount that is less than their initial investment.**

# Currencies

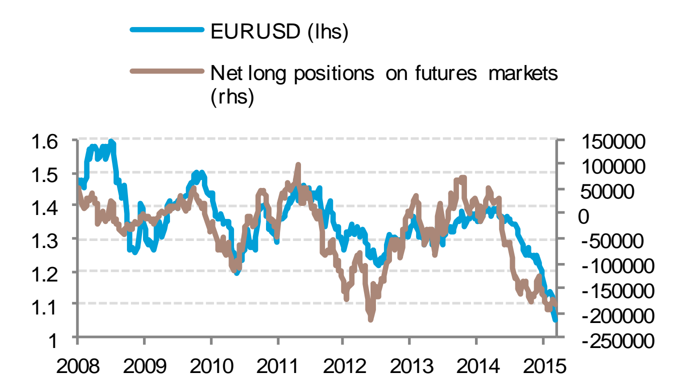
## EUR/USD: Recent depreciation curbs downside risks

**Most downside risks for the euro have already been priced in.**

*Real effective exchange rate* (*REER*): the weighted average exchange rate of a currency relative to an index or basket of other currencies, adjusted for the effects of inflation. The weights are determined by comparing the relative trade balances of the countries in the index.

On the back of the announcement and implementation of the European Central Bank's Quantitative Easing (QE) programme, the euro has slid much faster than anticipated. After losing 19% against the USD between early September and mid-March, euro weakening is due for a pause. The euro has returned to levels last seen in 2003 both against the dollar and, more importantly, from a real effective exchange rate standpoint. The euro's overvaluation has been corrected, and it now looks slightly cheap compared to its intrinsic value. Indeed, any fresh declines in consumer prices would only boost euro area competiveness further. Although monetary divergence will continue - we expect the US Federal Reserve (Fed) to hike interest rates by late 2015 - this has already been priced in and we currently see limited downside risk for the euro.

**EUR/USD and net long positions on futures markets**




Sources: Societe Generale Private Banking, Bloomberg Data as at 13/03/2015.

In addition, continuous monetary easing will face counterbalancing factors such as foreign portfolio and direct investments chasing value opportunities in the region. Also, the eurozone's current account surplus is set to rise further thanks to the weaker euro and a likely pickup in economic momentum. And short positioning on EURUSD (selling the euro against the dollar) is already at extreme levels (see graph). For these reasons, we doubt that the euro will trade below parity with the dollar – or at least, not for long. However, a lingering period of low valuation is on the cards and should be welcomed, as it would help restore growth and avoid a protracted episode of deflation.

On a 3-month horizon, we expect the euro to trade at around 1.07 vs the USD and on a 6-month horizon at 1.08, with a further slide towards 1.05 after the Fed's first hike.

## USD/GBP: Deficits and elections to weigh on the pound

**Range-bound market for the pound against the dollar, but further upside likely versus the euro.**

*Range-bound:* moving within a relatively narrow range for a certain period.

The pound has not been immune to the USD rally and has steadily lost ground since it peaked in July last year. Although the Bank of England is expected to raise interest rates - most likely in early 2016 - the low-inflation environment coupled with euro weakness are two good reasons for the central bank to "make haste slowly".

Domestic inflationary pressure has remained muted despite a buoyant job market. The fall in the euro and other European currencies against sterling has lifted the real effective exchange rate, leading to a tightening of monetary conditions. But the pound also faces downside pressure in the form of sizeable fiscal and current account deficits which, while shrinking slowly, still need to be financed by foreign capital inflows. The 7 May general elections could foster additional weakness, as - depending on their outcome - a referendum about EU

membership could be scheduled for 2017. So volatility is set to be a key feature, as was the case last year ahead of the Scottish referendum.

Over the coming six months, we envisage a range-bound market overall (GBP/USD at 1.46 on a 3 and 6-month horizon) with temporary weakness around the election.

## EUR/CHF: Swiss franc pricier, but stabilising

**The SNB removed the floor for the euro and could cut interest rates further to prevent appreciation.**

*Nominal effective exchange rate* (*REER*): the weighted average exchange rate of a currency relative to an index or basket of other currencies, without adjustment for the effects of inflation. The weights are determined by comparing the relative trade balances of the countries in the index.

The Swiss National Bank (SNB) caught the market off guard by scrapping the 1.20 floor for the euro against the Swiss franc last January. The central bank threw in the towel before the announcement of the ECB's QE because any further increase in its foreign reserves to stem the CHF's appreciation would have put its independence at risk: the sheer size of the reserves compared to the Swiss economy had generated mounting risks to financial stability. After skyrocketing, the Swiss franc soon levelled off around 12% higher versus the euro and a little less for the nominal effective exchange rate. The SNB will be reluctant to intervene in the forex market again, but may decide to cut interest rates in order to fight ongoing deflation in case of renewed upward pressure on the currency, which is already significantly overvalued. Although this may drive the Swiss franc slightly lower versus the USD, we doubt it could have any meaningful impact on EUR/CHF considering the size of the ECB's monetary easing. In fact, the resilience of the Swiss economy is impressive, as exporters have learned to adjust to a steady rise in the currency: the real effective exchange rate has appreciated by more than 25% since 2008, while the rate against the euro has gained more than 45%.

We expect the CHF to remain broadly stable versus the euro at 1.08 on a 3 and 6-month horizon.

## USD/JPY: Interest rate differentials to drive the yen lower

**The BoJ remains ready to act should inflation expectations disappoint.**

After the surprise adoption of a new round of qualitative and quantitative easing in October 2014, the Bank of Japan (BoJ) has remained on hold and the yen has hovered around the 120 mark. As a "safe-haven" currency, the yen remains sensitive to global risk appetite, but for the months ahead monetary policy expectations on both sides of the Pacific will hold the key to its movement. The BoJ has proved comfortable with the current level of the yen, as a further drop would have damaged consumer confidence, which was recovering slowly after being hit by the consumption tax hike in April 2014. Although headline inflation may dip below zero on the back of weaker commodity prices, the BoJ will continue to focus on the output gap (the difference between actual and potential GDP) and on long-term inflation expectations. If economic data disappoint, there could be a reaction from the BoJ, but the scope for additional bond purchases is narrow given the magnitude of the current purchases. Two factors are likely to push the yen further down: Japanese portfolio and foreign direct investment outflows are accelerating as institutional investors diversify their allocations out of domestic assets and manufacturers continue to expand their footprints abroad. Also, expectations of Fed tightening and a widening spread between US and Japanese interest rates are set to trigger a renewed slide of the yen.

On a 3-month horizon, we expect USD/JPY to be around 122, and on a 6-month horizon at 125 as we get closer to the Fed's first interest rate hike.

# EM currencies: Asian currencies still better positioned

**Improving fundamentals and sound economic policies will help withstand the Fed's tightening.**

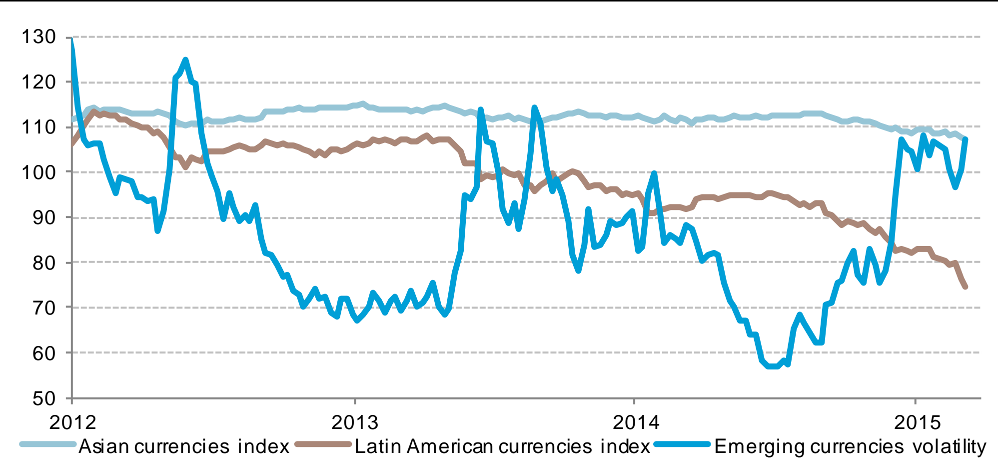
Emerging currencies have been generally hit hard by the USD rally and the related drop in commodity prices. Emerging market (EM) currency indices have dived past historical lows and there is a risk of further downside, as monetary policy easing and worsening terms of trade will extend further. The market is fretting about the buildup of leverage in the emerging market corporate sector, and the uncertainty about the timing of the Fed's rate hike will feed into an increase in volatility and renewed downside pressure on some currencies. Not all currencies are equally exposed to this risk. Since 2013 and the "taper tantrum" (when emerging market currencies and assets reacted badly to fears of reductions in the Fed's bond purchases), some countries have taken appropriate action in order to curb domestic and external deficits and rebalance their policy mix. But others remain plagued with weak or deteriorating fundamentals (deficits, inflation etc.), lacklustre growth and even recession. Clearly, most countries in the first category are Asian, whereas a large portion of Latin American and EMEA (Europe, Middle East and Africa) currencies still carry downside risks. Commodity price falls have been a windfall for importers – reducing trade imbalances, taming inflation and even lowering public spending, as energy subsidies can be cut more aggressively – but they have exacerbated problems for exporters.

Unsurprisingly, Asian currencies (such as the Indian rupee, the Taiwan dollar, the Korean won or the Philippine peso) should show resilience versus the strong USD, as they benefit from cuts in energy bills and strong current balances, and can take advantage of broadening economic growth.

In Latin America there is scope for additional weakness, given the dire shape of the Brazilian economy combined with the impact of bleak commodity price prospects driven by China's structural economic slowdown. Only the Mexican peso might remain broadly stable versus the USD, assuming some monetary policy intervention to prop up the currency.

In EMEA, we maintain our bearish view on the most widely traded currencies. Lingering inflation, macroeconomic policy mismanagement and some geopolitical risks could continue to exert downward pressure on the Turkish lira, the South African rand and the Russian ruble. Only the Polish zloty could reasonably be expected to strengthen against the euro given the country's robust growth and very low trade exposure to Russia.

**EM currencies index and volatility (basis 100 at 01/01/2005)**




Sources: Societe Generale Private Banking, Bloomberg. Data as at 13/03/2015.

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# Theme

## Currencies: Looking for investment opportunities

Although investors often tend to hedge out currency risk when planning investments, we see some interesting opportunities in currencies themselves over the next six months. The bounce in volatility which began in mid-2014 when currencies began to reprice should continue, as normalisation of the US Federal Reserve (Fed)'s monetary policy is looming and commodity prices may continue to move sideways.

**The USD will continue to gain traction against most other G10 currencies.**

We maintain a bullish view on the **USD**, but a pause is certainly due in the short term as the Fed remains dovish. The Fed will nevertheless be the first major central bank to hike interest rates, while other developed economies are fighting deflation risks (**EUR**, **JPY**) or are likely to cut interest rates further to accommodate softer growth driven by receding commodity prices and China's structural economic slowdown (**AUD**, **CAD**). The reduction in US fiscal and current deficits thanks to sustained growth and the shale energy revolution are also supportive forces for the USD.

Among G10 currencies, we expect further downside for commodity-related currencies (**AUD**, **CAD**, **NOK**, **NZD**) versus the USD, as terms of trade will continue to worsen and overvaluations have not been fully corrected despite significant weakening. Among Scandinavian currencies, the steady depreciation of the Swedish krona (**SEK**) against both the euro and the dollar seems overdone. Sweden should benefit from the US-led global trade expansion, and we see potential upside over the medium term (3-6 months), despite recent easing measures. Although Denmark may continue to ease in order to maintain the Danish krone (**DKK**)'s peg to the euro, we cannot rule out the idea that financial stability costs may eventually become too high and that the currency may break out. This is still a low-probability scenario, but risks are tilted to the upside for the krone. Within emerging Europe, the robust expansion of the Polish economy should pave the way for currency gains for the zloty (**PLN**) against the euro.

**Commodity-related currencies remain at risk of further downside.**

Further downside is due for the currencies of emerging commodity-related countries. High dependence on revenues from commodity exports, sometimes amplified by poor economic policies, may continue to drag down currencies such as the Brazilian real, **BRL**, and the South African rand, **ZAR**. There could however be some exceptions, as the sell-off has so far been largely indiscriminate. We identify two candidates for reappreciation versus the USD at some point, the Chilean and Colombian peso (**CLP** and **COP**). Both economies are more diversified than other traditional commodity exporters, and the sharp depreciation has offered a boost to agricultural and manufacturing exporters to the US.

In Asia, we consider that the Chinese yuan (**CNY/CNH**) and the Indian rupee (**INR**) will broadly keep pace with the USD. China is unlikely to let its currency weaken significantly, while India will be keen to dampen appreciation pressures driven by improving fundamentals and accelerating growth momentum. Both may outperform other Asian currencies, which could in turn signal some upside versus the euro.

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# Equity markets

## Risk of equity sell-off looms

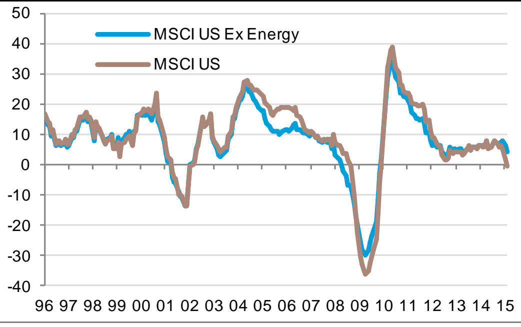
*Price to earnings ratio (P/E):* share price divided by earnings per share.

Since the publication of our Outlook 2015, a number of unexpected positive shocks have sustained equity performances. Oil prices have now lost more than 50% in just six months, bond yields are close to all-time lows, inflation is falling around the globe and many central banks in both developed and emerging countries have cut interest rates. On the back of the surge in equity performances, stock valuations (price to earnings ratios) are now expensive and well above multi-year averages. Since the beginning of the year, financial analysts have cut their earnings growth expectations in the US and in Europe. And while the low-rate environment is supporting financial asset reflation, global economic growth remains fragile in many emerging countries, especially in those which rely on energy and commodity exports.

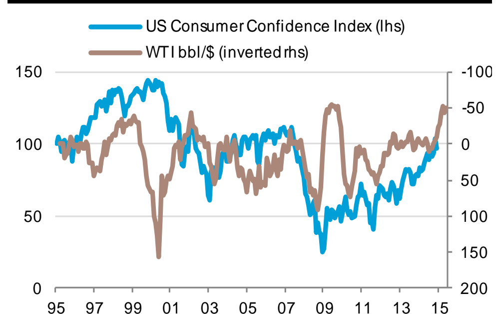
**The appreciation of the dollar combined with the drop in energy prices is putting US EPS profit growth under pressure.**

The combination of the USD appreciation with the drop in energy prices has had a negative impact on US earnings. Profit growth expectations have been cut, and at the time of writing (13 March 2015), earnings downgrades continue. The appreciation of the dollar relative to all major currencies has hit US multinationals hard. Moreover, the drop in energy prices has put oil majors - which represent 10% of the benchmark MSCI US index's market capitalisation - under pressure. Unfortunately, according to our calculations it usually takes about 15 months before the US consumer feels the increasing purchasing power which follows a drop in gasoline prices. In addition, we expect business and consumer spending trends to strengthen in response to the stimulus provided by lower import prices. So an increase in consumption should drive earnings upgrades in the region later this year. Our main concern about US equities remains linked to the timing of the US Federal Reserve (Fed)'s first rate hike. We believe that as long as investors are waiting for the Fed to act, the benchmark US S&P 500 index is unlikely to break above current levels (2100-2150).

**US EPS growth, with energy and ex. energy**




**Positive effect on consumption of fall in West Texas Intermediate (WTI) crude oil prices**




Sources: Societe Generale Private Banking, Datastream. Data: 13/03/2015.

**Past performance is not an indicator of future performance.**

**We would take a Neutral stance on US stocks**. We Overweight Technology companies (ex communication equipment), given their high sensitivity to improving economic growth. Financials offer attractive upside thanks to a combination of cheap valuations and improving prospects for margins (with an increase in bond yields on the horizon). The relatively high valuations of Industrials - and for some sub-sectors the negative impact of the dollar's appreciation - will limit their upside: we suggest a Neutral allocation. Valuations for the Energy and Basic materials sectors are not compelling, given our cautious outlook on commodity prices: we move to Underweight. Finally, defensive sectors look expensive.

**A further depreciation of the euro relative to the major currencies may drive EPS growth above our current forecasts.**

*Real effective exchange rate* (*REER*): the weighted average exchange rate of a currency relative to an index or basket of other currencies, adjusted for the effects of inflation. The weights are determined by comparing the relative trade balances of the countries in the index.

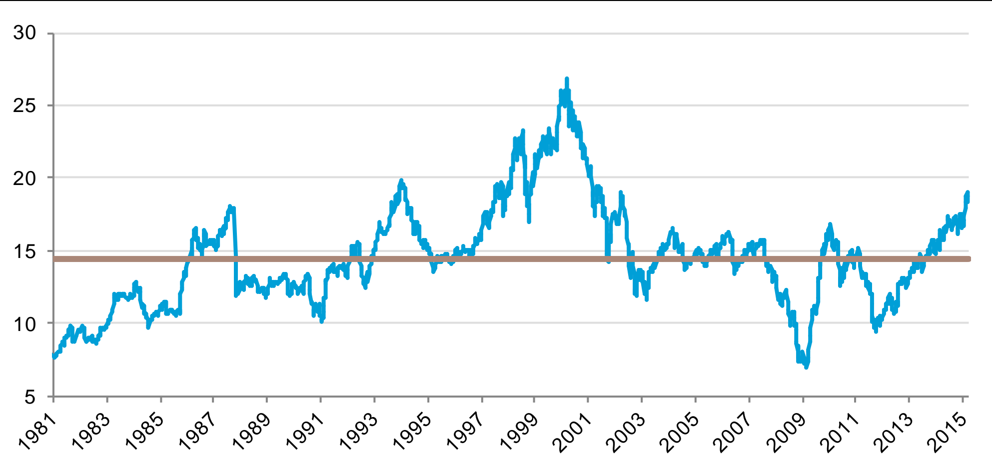
The *price-to-book* ratio (P/B) is used to compare a stock's market value to the book value on its balance sheet

Growth in earnings-per-share (EPS) in the eurozone remains subdued. The drop in energy prices and the big depreciation in the euro relative to the dollar should boost exports. However, we observe that global demand is not strong enough to drive profit growth up steeply. Earnings growth should be around 5% in 2015 under our **base case scenario** which uses the following assumptions: €/$ remains around current levels (1.06 on 13 March) until the end of the year; the euro's average real effective exchange rate will fall 11% on the year; average GDP growth for 2015 will be 1.6% (the Bloomberg consensus forecast); average inflation will be -0.2%; the money supply will expand further; oil prices will average $50 per barrel over the year, and global real GDP growth will be 3%. Under our **blue sky (best case) scenario** - assuming parity for the €/$, a bigger depreciation in the effective exchange rate (-20%) and more growth in money supply - profit growth could be 10-15% by the end of the year. On the back of the euro's depreciation and following the ECB's announcement of its bond purchase programme, valuations (P/E and price to book value, P/B) have risen even higher. The P/E for the benchmark MSCI eurozone index is now at a 28% premium relative to its 25-year average, and has returned to highs previously reached in 2003. Given this expensive valuation coupled with low potential for earnings growth upgrades, **we suggest a Neutral position on eurozone stocks**.

Sector-wise we prefer cyclical discretionary sectors, which should benefit from negative bond yields and low energy prices. We also like eurozone Industrials which export to the US and are supported by the drop in input costs.

*Trailing P/E(x)* is calculated as the price of the index divided by the EPS of the index itself.

MSCI eurozone trailing P/E(x)




Sources: Societe Generale Private Banking, Datastream. Data as at 13/03/2015.

**While we slightly reduce exposure to UK stocks ahead of the May general election, we still see upside potential in non-eurozone Europe**.

**We also see some upside potential in non-eurozone Europe**. The risk related to the UK elections and the re-appreciation of sterling relative to the euro (headwinds for exports and competitiveness) may dampen investor appetite for UK assets. In addition, a possible increase in bond yields may hit UK stock valuations. However, resilient internal demand should provide medium-term support to the market after the elections. We downgrade our UK stock exposure from Overweight to Neutral. **We continue to Overweight the Nordic and Swiss stock markets.** Valuation is generally expensive in these regions, but long-term corporate profit growth potential is mostly more resistant to external shocks and higher than that in the euro area. In addition, most of the companies included in the benchmarks generate steady cash flows and are able to pay recurrent dividends.

Although the Japanese stock market has been the best performer year-to-date in common currency terms, we still see further upside in **Japanese stocks (rated Overweight).** Profit

growth is positive this year, despite the increase in the consumption tax and the consequent impact on consumer-related companies (EPS growth of 6% for the 2014/2015 fiscal year ending 31 March), and should be stronger next year (2015/2016 EPS growth expected at 10%-15%). P/Es for export-related sectors (e.g. Industrials) are now becoming expensive, as the depreciation of the yen has sustained the performance of these stocks. As we expect wages to rise, we now believe profit growth will be generated in the Consumer Staples and Consumer Discretionary sectors. Financials also remain attractively valued.

**Asia Pacific ex Japan (Overweight)** has performed strongly. Australia now looks less attractive (expected 2015 P/E 16.2x) than a few months ago, while Singapore still offers value (13.7x for 2015). Overall, Asia Pacific remains the place to be. In the short term the region may mark a pause, but over the long term we see still potential for a positive trend.

2015e EPS growth forecasts (%) and index forecasts

| | IBES consensus forecasts | *SGPB forecasts | *SGPB index forecasts | Close (13/03/15) | Upside potential according to SGPB |
|---|---|---|---|---|---|
| S&P 500 | 1.6% | 2.5% | 2100 | 2065 | 2% |
| DJ Euro Stoxx 50 | 9.2% | 5.0% | 3470 | 3629 | -4% |
| FTSE 100 | -7.4% | 3.0% | 7100 | 6736 | 5% |
| Topix | 8.5% | 6.0% | 1650 | 1560 | 6% |
| SMI | -5.2% | -5.0% | 9000 | 8955 | 1% |

Sources: *Societe Generale Private Banking (SGPB), Datastream, IBES. Data as at 13/03/2015.

**We take a selective approach among emerging countries. We move from strongly Overweight to Overweight on emerging Asia, and further reduce exposure to Latin America and Russia from Underweight to strongly Underweight.**

The allocation across **emerging countries remains unchanged, with a preference for Asia (Overweight) over Latin America and EMEA (both Strongly Underweight).** We continue to favour oil importers vs oil producers. The strong appreciation of the dollar versus emerging currencies represents the major risk in this universe. We would avoid countries with large external deficits and which export commodities and energy (Brazil and South Africa).

We suggest upgrading Indonesia from Underweight to Neutral, and we downgrade Colombia from Neutral to Underweight. We also downgrade Greece to Neutral. Among sectors, we upgrade Telecoms to Overweight in Asia and Telecoms to Neutral in Latin America.

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# Equity themes

## 1. Increase in shareholder returns should further sustain Japanese stocks

Since December 2012, Japan's Topix stock exchange index has risen by 115%. Many factors have supported this increase, but the most important has been the depreciation of the yen vs the dollar and the euro. Since January, the yen has stabilised, yet Japanese stocks are still performing well. Why is this?

**Shareholder returns are clearly the most important of the structural and cyclical factors supporting Japanese stocks. We note that when companies launch share buybacks, their performance is more resilient to external shocks.**

We have demonstrated in previous reports that the Japanese stock market has entered a period of structural change. We believe that the Topix's current upward trend is mainly driven by such changes. First, local investors now have more appetite for equities than for bonds. With inflation in positive territory and bond yields close to all-time lows, the Bank of Japan's asset purchase programme has shifted from bonds to include equities. The Government Pension Investment Fund has also increased its exposure to Japanese equities. These inflows sustain performance and make Japanese stocks more resilient to external shocks. Second, the Japanese government's push to improve corporate governance and increase return on equity (RoE) has motivated corporate management to boost shareholder returns (which can be achieved through dividends or share buybacks): the Bank of Japan's asset purchase programme focuses on companies with high RoE. Experience suggests that stock markets which are driven by higher shareholder returns are more resilient than those which are driven only by cyclical forces. Finally, a cyclical factor is also sustaining Japanese stocks: profit growth. Japan is the only market to have delivered positive profit growth annually since 2012. As profits and dividends are strongly positively correlated, the acceleration in growth in earnings per share (EPS) should result in an acceleration in dividend growth.

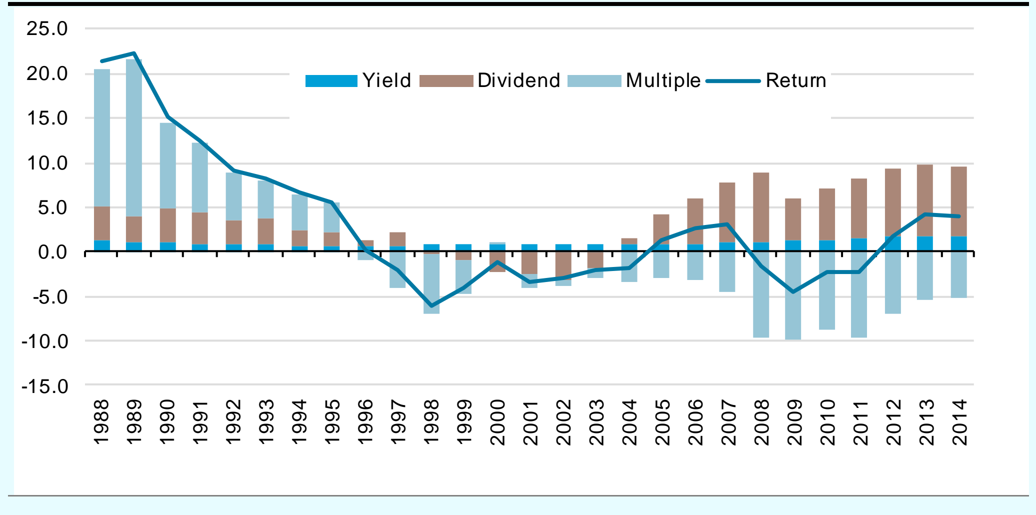
**Strong correlation between Topix and yen**

$/JPY (lhs)
Topix

Sources: SG Private Banking, Datastream. Data as at 16/03/2015.

**In 2013 and in 2014, shareholder returns of Japanese companies rose to above pre-crisis levels.**

**MSCI Japan index – rolling 10y average nominal returns (changes, %)**




Sources: Societe Generale Private Banking, Datastream. Data as at 13/03/2015.

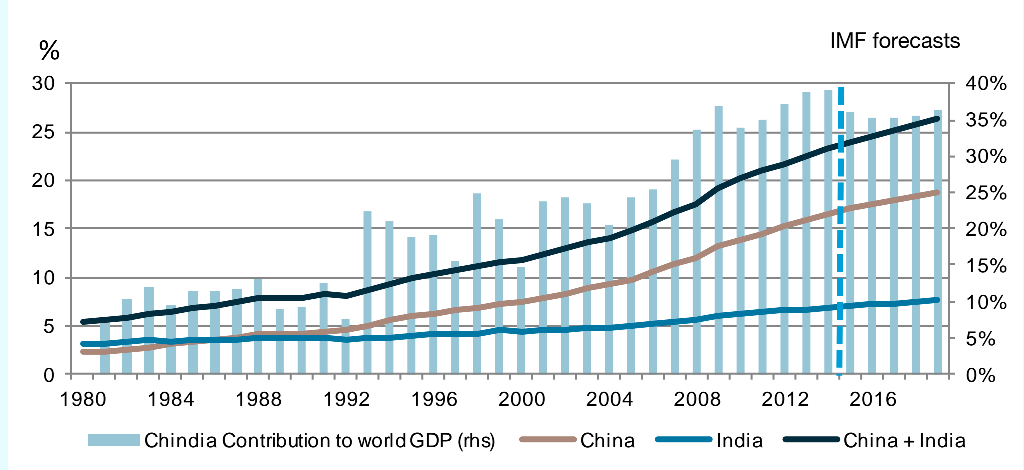
# Equity themes

## 2. China & India: becoming global leaders

**China and India are committed to economic reforms, and this is currently rewarded by markets.**

Starting from two different points, China and India are set to shape the future of the global economy thanks to their size, favourable growth prospects and increasing global footprint. Their combined economies may grow at an average real rate of about 5% in the coming five years (IMF, *World Economic Outlook 2014*), contributing more than 1 percentage point to global growth. We can draw some parallels between the two countries, both of which are embarking on a broad-based series of reforms.

**Share of world GDP (in purchasing power parity terms), contribution to world GDP growth**




Source: Societe Generale Private Banking, IMF. Data as at 23/03/2015.

### Embracing structural reforms to support growth potential

Both economies are striving to carry out sweeping economic and political reforms which will support long-term economic growth. In India, cutting red tape and reining in corruption will help create a more business-friendly environment. The streamlining of administrative procedures, the facilitating of land acquisitions for large-scale projects and the adoption of a digital initiative are all designed to cut the lag between projects and completion and curb the cost-burden of excessive regulation on the economy. China is also moving towards a more market-based economy, and is aiming to improve efficiency and boost innovation by increasing the role of the private sector. With the reform of state-owned enterprises and increasing mergers and acquisitions aiming at cutting back excess capacity, China's industrial sector will be able to climb further up the value chain, capturing a larger share of value-added in the goods manufacturing process.

### Boost to domestic and international infrastructure

**India needs to focus on domestic infrastructure, while China is ready to focus on overseas expansion.**

Both countries are set to extend their roles as global players in manufacturing. In India, the priority given to infrastructure projects can be compared to the massive fixed investment buildup China conducted from 1980s onwards: patchy infrastructure creates bottlenecks in many industries. India intends to strengthen its manufacturing base, improving its export capacities and thus restoring its current account position. The latest budget bill presented in March highlights the priority given to spending on renewable energy, road and rail infrastructure and affordable housing. China looks fairly well-equipped in comparison, but its focus is now turning international. As China wants to spread its regional influence, its New Silk Road

initiative will fund investment in neighbouring countries and open up new markets for its corporate sector. Foreign direct investment (FDI) outflows will top FDI inflows in 2015 for the first time in history, as Chinese companies are looking to make acquisitions overseas. This should drive the international expansion of large businesses with global ambitions, which have critical mass on their domestic markets.

**Domestic consumption to underpin long-term growth**

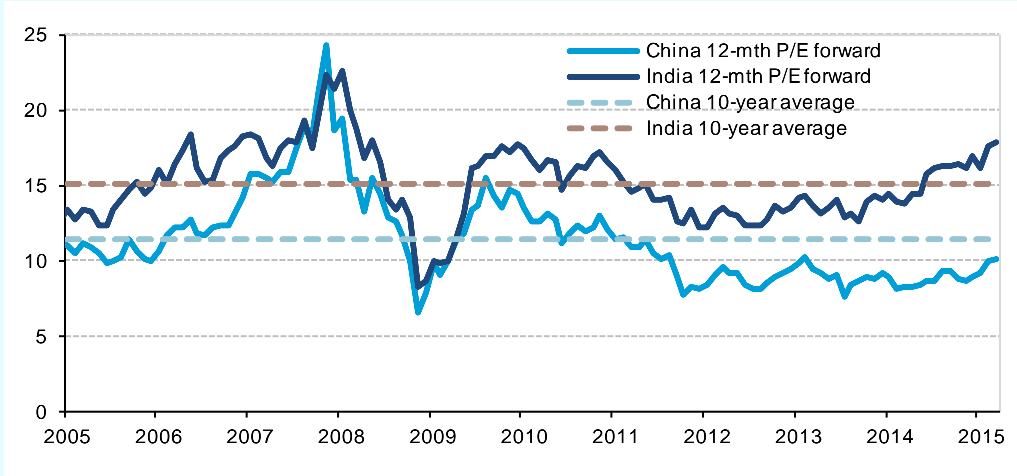
**Private consumption will become a more prominent growth driver in both countries.**

Labour migration from rural to urban areas has always been a major growth driver thanks to the productivity gains it produces. China has one of the largest urbanisation levels in the emerging world, at over 50%, while that of India is only 32%. For India, a steady increase in urbanisation will boost productivity and will also favour the expansion of the middle class, the traditional backbone of domestic private consumption. Clearly, a convincing investment effort in "hard" (transportations, energy, telecommunications) and "soft" (social institutions, education) infrastructure will be required for success. In China, urbanisation has mainly favoured the rise of industry thanks to the very large pool of cheap labour moving to the industrialised coastal areas. Expanding the social safety net and putting more emphasis on the labour-rich services sector will increase the contribution of private consumption to GDP, which is currently only slightly above 40%.

**Financial reforms in the pipeline**

In both countries, the financial sector still looks rather inefficient compared to international standards. Increased competition in India, market liberalisation in China and the further opening up of the capital account in both countries should pave the way for a better-managed banking sector. This would contribute more efficiently to private sector growth, and facilitate access to financial services for low-income earners. In India, the partial privatisation of state-owned banks may attract foreign direct investment, paving the way for efficiency gains. Other reforms regarding financial market regulation and the launch of new investment products aiming to steer investors away from gold holdings suggest a big market shake-up. In China financial liberalisation will continue, with growing importance attached to market mechanisms. The financial sector needs to strengthen its ability to manage interest rate and currency risks in line with deposit interest rate liberalisation, the move towards a more flexible exchange rate and increasing capital inflows and outflows.

China and India 12-month forward price/earnings ratio




Sources: Societe Generale Private Banking, IBES, Datastream. Data as at 23/03/2015.

# Equity themes

## 3. Declining oil prices to fuel global consumption

**The decline in energy and other commodity prices, combined with the low interest rate environment, will foster consumer appetite.**

The major consequence of the energy price slump is an increase in purchasing power, especially in those economies where the drop is fully reflected at the pump. Declining commodity prices across the board only add to this gain. With interest rates at all-time lows, we can reasonably expect that this improved buying power will mostly be oriented towards consumption rather than savings. We therefore anticipate a rise in global consumer spending, driven not only by the 50% drop in Brent prices but also by these other factors:

- In the United States, as a consequence of the positive economic momentum, the labour market continues to improve, with job creation surprising on the upside. Although wage growth has so far remained modest, further declines in the unemployment rate will fuel wage inflation and in all likelihood a boom in US consumption.
- Consumer prices have declined in the eurozone over the past few months. Both energy and food prices have fallen, increasing European consumers' buying power. With the introduction of a minimum wage in Germany and taxes expected to remain stable in France, purchasing power and consumer confidence are likely to pick up.
- Japanese Prime Minister Shinzo Abe has recently re-emphasised the importance of Japanese corporate leaders raising wages. And after a first increase in the consumption tax in April 2014 hit retail sales, the next one was postponed from October 2015 to April 2017. Both factors should boost consumer confidence and spending.
- The rebound in household demand will also come from emerging markets. Automobile sales in China have been - and should remain - on a strong upward trend, while Indian consumers will benefit from the slump in food, energy and electricity prices.

Globally, we expect strong profit growth from Consumer Discretionary stocks for both 2015 and 2016. As a major beneficiary of this boom in global consumption, the sector constitutes one of our biggest convictions.

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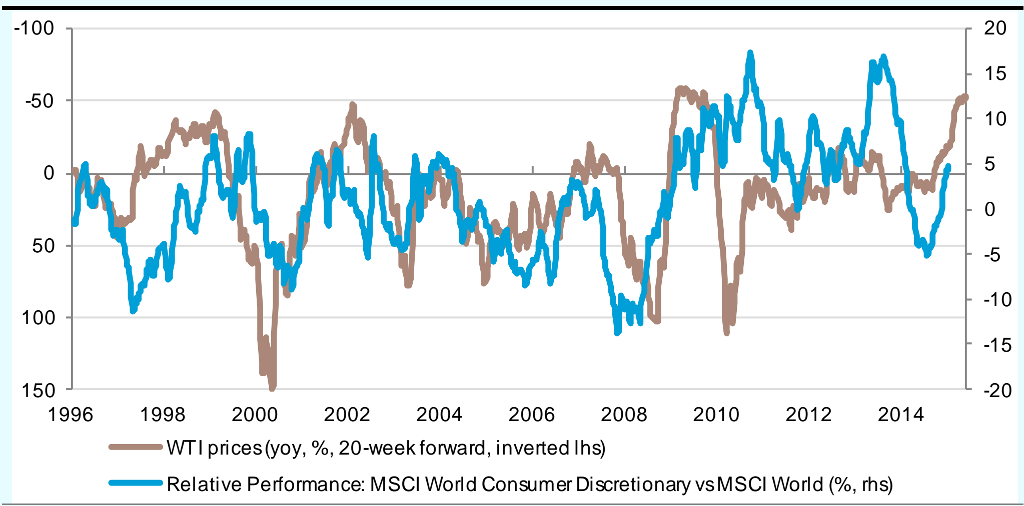
**Oil slump fosters outperformance in Consumer Discretionary sector**




Sources: Societe Generale Private Banking, Datastream. Data as at 18/03/2015.

# Equity themes

## 4. Internet of Things: are you connected?

**The inexorable advance of the Internet of Things will change our lives - again.**

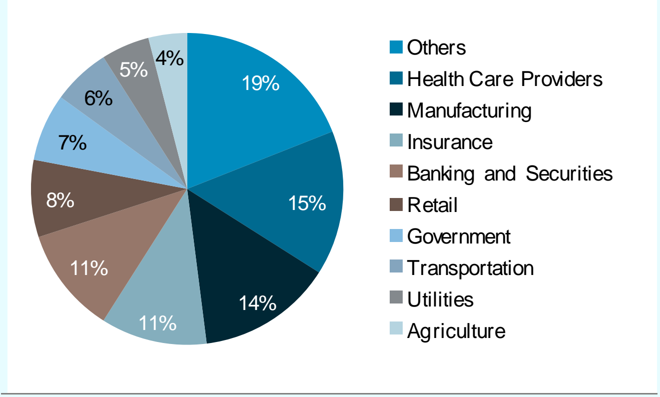
Twenty years ago, we never imagined that our everyday life would change so drastically thanks to the internet revolution. But since then, the internet has become practically indispensable. After the development of the personal computer and the unprecedented spread of internet access, we entered a new era of communication with smartphones and tablets that could also be connected to the internet. And thanks to ongoing innovation in technology, we are now at the beginning of the next wave, the Internet of Things (IoT). This sub-set of the Internet of Everything (IoE) covers a host of uniquely identifiable everyday devices (including wearable devices, home appliances, automobiles, industrial machines, power grids, traffic control systems and healthcare services), equipped with sensors, microcontrollers and wireless modules which enable them to interact with their environment and to make smart decisions by collecting and analysing real-time data.

**A global market expected to grow by more than $19 trillion.**

A report from the UK Government (*Internet of things: making the most of the second digital revolution*, December 2014) estimates that connected mobile devices and smartphones could outnumber the global population by 2020, by which time the number of connected devices could be between 20 billion and 100 billion. The market potential for IoT and IoE is therefore enormous and as so many sectors are concerned, every single company could be affected. According to a report to the World Economic Forum, *Are you ready for the Internet of Everything?*, by Cisco Chairman John Chambers in January 2014, IoT and IoE could potentially generate some $19 trillion in turnover between 2013 and 2022.

This rapid growth is driven by the low price of components, the improvement of wireless connectivity and the expansion of "big data" and analytics. It is also boosted by the fact that consumers, businesses and governments alike are recognising the benefits in terms of revenues, cost savings and improvements to daily life. IoT can offer many new opportunities for productivity - increasing efficiency by creating new services, freeing up human capital or improving customer satisfaction. The industrial internet (the integration of machines, sensors and software), supply chains & logistics and smart cities (where digital technology is embedded across all functions) are just some examples of how IoT can be applied. This new revolution is of course raising concerns in terms of data privacy/security, with many organisations, such as the US Federal Trade Commission, urging companies to adopt practices to protect consumers. The standardisation of protocols and better pricing with economies of scale will be other key challenges.

**Total economic value-added* by 2020, by sector**




Sources: Gartner, Societe Generale Private Banking (Equity Solutions & Strategy), Nov.2013.

* Estimated aggregate benefits businesses will derive through sale and use of IoT technology

We are only at the first stage of a great transformation that is likely to have even more impact than the first 20 years of the internet.

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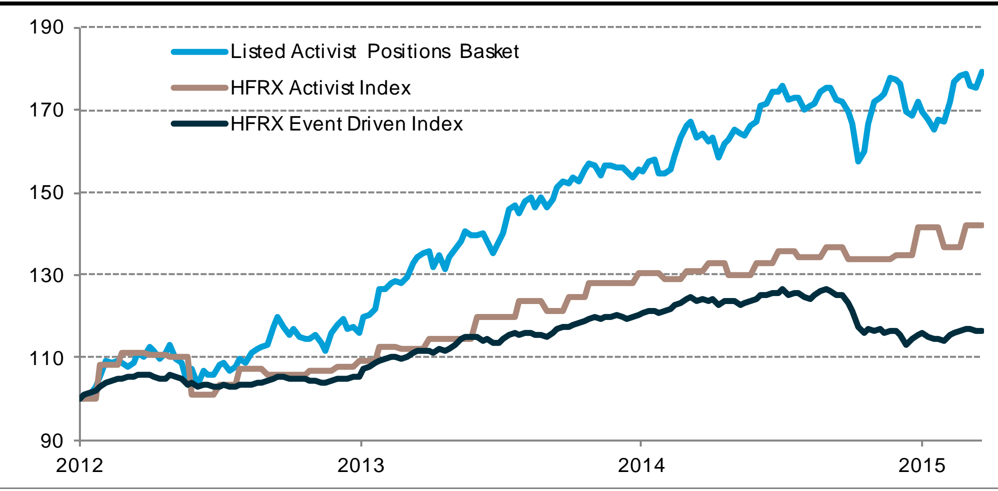
# Hedge funds

## Diversification rather than direction

Returns from global hedge funds have picked up over the past three months, after marking time over the first 11 months of 2014. This improvement has been driven by a number of factors – improved appetite for risky assets in anticipation of ECB asset purchases and better liquidity in financial markets, combined with the three major macroeconomic themes that have dominated markets recently: the collapse in oil prices, growing worries about deflation risks and clear global economic divergences. This period has been particularly favourable to more macro and momentum-oriented funds, which have benefited from their directional exposure.

However, these trends have also benefited long-only equity and fixed income investors in a much more direct manner. We therefore recommend Underweighting more directional strategies such as Global Macro, Long-Bias Equity and CTAs in portfolios and concentrating instead on direct investment in traditional asset classes for exposure to directional moves in the markets. One area we find relatively attractive is **Special Situations** – an area dominated by activist managers, many of whose positions should now see value gradually being unlocked.

Activists are having an impact (base 100 in 2012)




Sources: Societe Generale Private Banking, Lyxor Cross Asset Research. Data as at 13/03/2015

**Given the increasing correlations between directional hedge fund strategies and the underlying asset classes, we prefer to diversify exposure into Relative Value strategies.**

In this context we prefer Relative Value strategies, where we would highlight the following areas: **Market-Neutral Equity** - in the US, investors should search for managers who are sector-neutral, i.e. whose strategies will not be exposed to sharp divergences in performance between sectors. Elsewhere, the best opportunities are to be found in managers who use quantitative models to construct their portfolios; **Long-Short Credit** - here, investors should focus on exposure to European and emerging credit markets, which offer some of the best possibilities for generating absolute performance; **Fixed Income Arbitrage** - funds in this segment are exposed to many of the same return drivers as Global Macro strategies (in particular, diverging trends in foreign exchange and fixed income markets) but in a Relative Value framework, making them less vulnerable to directional shifts in these markets.

These strategies offer non-directional exposure to financial markets, which represents an attractive alternative source of returns and, as such, a useful instrument to diversify portfolios.

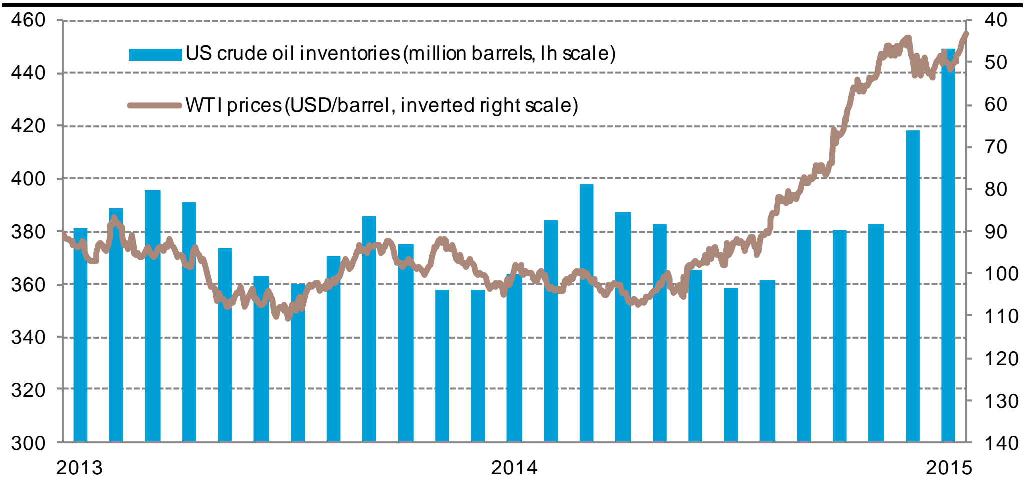
# Commodities

## Oil has little appeal, neither does gold

**We expect oil supply to continue to outstrip demand, though the imbalance should not increase significantly. Oil prices should therefore remain around current levels.**

Over the past quarter, the global outlook for oil has not changed much. Supply has been outpacing demand, and this should remain the case in the coming months. The price war between OPEC and non-OPEC – basically between Saudi Arabia and the US – is unlikely to cease. The two players intend to maintain high levels of production in order to preserve their market share. At 449.8 million barrels in March 2015, US crude oil inventories were the highest in over three decades, as was output at 9.37 million barrels per day. At this pace, storage capacity will fill up rapidly. In contrast, the global economic recovery remains sluggish, meaning that growth in demand is tepid. The International Energy Agency (IEA) forecasts that global oil demand should increase only marginally in 2015, by 1 million barrels per day. A possible deal over Iran's nuclear programme could lead to a further increase in global oil supply. Iran has OPEC's third largest reserves, and an increase in its exports would add to downward pressure on prices in the near term. So we expect supply to continue to outstrip demand over the coming quarters, though the imbalance should not worsen significantly. As a result, oil prices should continue to range around current levels.

US oil inventories up, oil prices down




Sources: Societe Generale Private Banking, Datastream. Data as of 17/03/2015.

**We maintain a Negative stance on gold, though we expect downside to be limited.**

Regarding gold prices, increases in emerging central bank gold reserves and robust seasonal physical demand from Asian retail investors could provide support in the short run. Also, exchange-traded fund (ETF) gold holdings have bounced back since the end of 2014. However, the shift in the Fed's monetary policy will be crucial. Should US macroeconomic readings continue to look strong – and there is currently no reason to expect otherwise – the anticipation of further monetary tightening by the American central bank will add to downward pressure on gold prices. Finally, as we expect the US dollar to continue to strengthen against most other currencies, its historically negative correlation with precious metal prices will weigh on gold. Overall, we retain a Negative stance on gold, though reduced production at current price levels should limit the extent of any downside.

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# Tactical and strategic themes: open strategies

| Inception date | Conviction | CUR | Strategy description | Status | Time horizon* |
|---|---|---|---|---|---|
| 01/12/2013 | European banks beauty contest (bonds) | EUR | Accommodative monetary policy will ease funding conditions. Bond redemptions will continue to outpace bond issuance, providing support for the financial bond market. | Open | Strategic |
| 01/12/2013 | Investment cycle gathering speed | USD | Business fixed investment has been relatively weak in developed markets for several years, but we now expect a rebound in global capex. | Open | Strategic |
| 19/03/2014 | TOPIX - Multiples rerating still underway | EUR | We believe that Japan is moving towards a structural change. The exit from deflation should strongly support stock market re-rating. | Open | Strategic |
| 12/06/2014 | Asia : Go East | EUR | Asia-Pacific combines attractive valuations, potential upward earnings forecasts and supportive monetary and fiscal policies. | Open | Strategic |
| 12/06/2014 | Eastern Europe back in the game (bonds) | EUR | The macroeconomic backdrop in Eastern Europe has improved. | Open | Tactical |
| 12/09/2014 | Switching from European value to USD-exposed growth stocks | EUR | With leading indicators pointing to lacklustre economic growth in the euro area and euro depreciation on the back of the ECB's action, companies with business outside the eurozone benefit from a positive currency effect and a positive volume effect as eurozone exports become cheaper. | Open | Tactical |
| 12/09/2014 | Cheap valuations in Scandinavian equities | EUR | Norway is the cheapest country in Europe. Swedish companies are more expensive, but earnings per share (EPS) growth should be in double digits. | Open | Tactical |
| 27/11/2014 | Eurozone dividends return to the spotlight (aristocrats) | EUR | Lacklustre economic growth and eurozone deflation risk should direct investors' attention towards dividends. | Open | Tactical |
| 27/11/2014 | Made in the USA | USD | Thanks to competitive labour costs and low energy prices, the US manufacturing sector is enjoying a particularly strong revival. | Open | Strategic |
| 27/11/2014 | Dollar appreciation: who stands to benefit most? | EUR | We favour exposure to companies exporting to the US. | Open | Tactical |
| 27/11/2014 | Blue gold (water) | EUR | Many regions of the world are currently susceptible to large water supply disruptions. Water remains underpriced. | Open | Strategic |
| 27/11/2014 | Attractive yields in emerging market sovereign debt | USD | Although the stronger dollar has made the EM carry trade less attractive, it should boost the competitiveness of EM countries and favour the narrowing of current account deficits. | Open | Tactical |
| 27/11/2014 | Sustained upturn in the German housing market. | EUR | High demand and short supply have led to a sharp increase in German property prices this year. However, residential housing in Germany still looks affordable compared with London and Paris. | Open | Tactical |
| 13/03/2015 | Increase in shareholder returns should further sustain Japanese stocks | JPY | Shareholder returns are clearly the most important of the structural and cyclical factors supporting Japanese stocks. We note that when companies launch share buybacks, their performance is more resilient to external shocks. | Open | Strategic |
| 13/03/2015 | Declining oil prices to fuel global consumption | USD | The decline in energy and other commodity prices, combined with the low interest rate environment, will foster consumer appetite. | Open | Strategic |
| 13/03/2015 | Internet of Things: are you connected? | USD | The inexorable advance of the Internet of Things will change our lives - again. | Open | Strategic |
| 13/03/2015 | Chindia : (China & India): becoming global leaders | USD | China and India are set to shape the future of the global economy given their size, favourable growth prospects and their increasing global footprint. The combined economies may grow at an average annual rate of about 5% in the next 5 years, contributing more than 1% to the global growth rate. | Open | Strategic |
| 13/03/2015 | Currencies: looking for investment opportunities | USD | After an impressive rally, there is still some additional upside to capture on the USD versus G10 commodity-related currencies and versus emerging currencies posting weak fundamentals, as both may weaken further ahead of the Fed's rate hike. | Open | Tactical |

Sources: Societe Generale Private Banking, Datastream. Data as at 13/03/2015. * Strategic: 1-3 years. Tactical: 3-12 months.

# Closing strategies

**Capital expenditure recovers in the US:** While capex-related sectors are cheap and capital spending growth has not yet reached our target, the strategy has already performed well. In addition, we see the change in the Fed's monetary policy as generating some volatility in US stocks, including those in capex-related sectors (such as Industrials and Technology).

**Euro banks beauty contest (equity):** We close the strategy linked to the sector's outperformance as the depressed levels of bond yields should limit growth in bank revenues. In addition, tough capital requirements applied to the largest banks may reduce the potential for dividend increases and sector consolidation.

**Looking for yields in Australian bonds:** Since the inception of the strategy, the 10-year sovereign bond yield has tightened by 120 basis points, supporting the strategy's performance. With US yields likely to rise in anticipation of Fed rate hikes, Australian bond yields may follow suit.

| | | CUR | Strategy description | Status | Closing date |
|---|---|---|---|---|---|
| 20/02/2013 | Capital expenditure recovers in the US | USD | US sectors linked to capital expenditure (capex) should outperform. | Closed | 13/03/2015 |
| 01/12/2013 | Euro banks beauty contest (equity) | EUR | Accommodative monetary policy will further ease funding conditions. The ECB's Asset Quality Review should ease market concerns about the soundness of the eurozone banking sector and whet investor appetite. | Closed | 13/03/2015 |
| 12/09/2014 | Looking for yields in Australian bonds | AUD | The yield curve is attractively valued (10-year yield at 3.6%) and we see opportunities in both sovereign and corporate credit bonds. | Closed | 13/03/2015 |

**Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.**

# Global economic forecasts

## GDP and CPI forecasts

| % changes yoy | Real GDP (f: forecast) | | | | CPI | | | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015f | 2016f | 2017f | 2014 | 2015f | 2016f | 2017f |
| **World (Mkt FX weights)** | **2.8** | **3.2** | **3.4** | **3.4** | **2.8** | **2.3** | **2.9** | **3.2** |
| **World (PPP* weights)** | **3.4** | **3.7** | **4.0** | **4.0** | **3.8** | **3.4** | **3.6** | **3.8** |
| **Developed countries (PPP)** | **1.8** | **2.6** | **2.5** | **2.3** | **1.4** | **0.5** | **1.9** | **2.3** |
| **Emerging countries (PPP)** | **4.6** | **4.6** | **5.1** | **5.1** | **5.6** | **5.5** | **4.8** | **4.9** |
| **Developed countries** | | | | | | | | |
| **US** | **2.4** | **3.5** | **3.0** | **2.9** | **1.6** | **0.0** | **2.3** | **2.9** |
| **Euro area** | **1.1** | **1.4** | **1.6** | **1.4** | **0.4** | **0.0** | **1.3** | **1.5** |
| Germany | 1.6 | 1.7 | 1.6 | 1.4 | 0.8 | 0.4 | 1.7 | 1.6 |
| France | 0.4 | 1.2 | 1.6 | 1.5 | 0.6 | 0.2 | 1.3 | 1.5 |
| Italy | -0.4 | 0.9 | 1.2 | 0.9 | 0.2 | 0.3 | 1.4 | 1.6 |
| Spain | 1.4 | 2.0 | 1.7 | 1.5 | -0.2 | -0.9 | 0.9 | 1.1 |
| **UK** | **2.6** | **2.6** | **2.0** | **1.8** | **1.5** | **0.7** | **2.1** | **2.2** |
| **Japan** | **0.0** | **1.4** | **2.2** | **1.3** | **2.7** | **0.7** | **1.2** | **2.9** |
| **Switzerland** | **2.0** | **1.6** | **1.7** | **1.8** | **0.0** | **-0.6** | **0.4** | **0.8** |
| **Australia** | **2.7** | **2.7** | **3.2** | **3.3** | **2.5** | **1.3** | **2.6** | **2.8** |
| **Emerging countries** | | | | | | | | |
| **China** | **7.4** | **6.8** | **6.6** | **6.2** | **2.0** | **1.4** | **2.3** | **3.0** |
| **South Korea** | **3.4** | **3.2** | **3.7** | **3.6** | **1.3** | **1.4** | **2.6** | **2.2** |
| **Taiwan** | **3.7** | **3.8** | **3.4** | **3.1** | **1.2** | **-0.3** | **1.7** | **1.4** |
| **India** | **7.3** | **7.4** | **7.7** | **7.7** | **n.a** | **5.5** | **5.0** | **5.1** |
| **Indonesia** | **5.0** | **5.3** | **5.8** | **5.9** | **6.4** | **6.5** | **4.9** | **5.0** |
| **Brazil** | **0.0** | **-0.3** | **1.2** | **1.9** | **6.3** | **7.3** | **6.2** | **5.7** |
| **Mexico** | **2.1** | **2.8** | **3.2** | **3.5** | **4.0** | **3.2** | **3.4** | **3.4** |
| **Chile** | **1.8** | **2.6** | **3.1** | **3.1** | **4.4** | **3.4** | **3.0** | **3.3** |
| **Russia** | **0.7** | **-3.5** | **0.5** | **1.1** | **8.5** | **15.4** | **5.9** | **5.5** |
| **Poland** | **3.3** | **3.5** | **3.5** | **3.6** | **0.0** | **-0.5** | **1.0** | **2.5** |
| **Czech Republic** | **2.3** | **2.3** | **2.7** | **2.2** | **0.4** | **-0.1** | **2.0** | **1.5** |

Sources: SG Cross Asset Research / Economics, IMF. Data published on 16/03/2015;

* PPP: Purchasing Power Parity

**Forecast figures are not a reliable indicator of future performance.**

# Market performance

## Developed markets performance

| | | 1m total return | 3m total return | YTD total return | 12m total return |
|---|---|---|---|---|---|
| ***(in local currency)*** | **Current level** | | | | |
| S&P 500 | 2053 | -1.89% | 3.09% | 0.20% | 13.51% |
| DJ Euro Stoxx 50 | 3656 | 6.05% | 19.63% | 16.48% | 25.47% |
| FTSE100 | 6741 | -1.38% | 7.93% | 3.53% | 6.44% |
| Topix | 1560 | 7.69% | 11.65% | 10.90% | 32.28% |
| MSCI AC World (USD) | 419 | -1.93% | 2.95% | 0.78% | 6.26% |
| ***(in local currency)*** | **Yield to maturity** | | | | |
| European IG | 0.84% | 0.33% | 1.84% | 1.49% | 7.25% |
| European HY | 3.69% | 1.30% | 3.10% | 3.16% | 5.85% |
| US IG | 3.07% | 0.01% | 1.17% | 1.19% | 5.83% |
| US HY | 6.24% | 0.12% | 3.71% | 2.03% | 1.93% |
| UK | 2.92% | -0.18% | 2.95% | 2.53% | 11.92% |
| Japan | 0.33% | 0.11% | -0.03% | -0.23% | 1.15% |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

## Emerging markets performance

| | | 1m total return | 3m total return | YTD total return | 12m total return |
|---|---|---|---|---|---|
| ***(in USD)*** | **Current level** | | | | |
| MSCI EM | 940 | -4.67% | 0.61% | -1.50% | 2.47% |
| MSCI EM Asia | 466 | -1.73% | 3.79% | 2.08% | 10.87% |
| MSCI EMEA | 260 | -9.80% | -2.12% | -3.66% | -9.37% |
| MSCI Latam | 2340 | -11.53% | -9.69% | -13.71% | -15.19% |
| ***(in USD)*** | **Yield to maturity** | | | | |
| BAML EM SVGN | 5.27% | -0.92% | 1.47% | 0.23% | 6.01% |
| *Asia Svgn* | 4.05% | -0.38% | 2.16% | 1.93% | 10.83% |
| *EMEA Svgn* | 5.01% | -0.41% | 1.31% | 1.06% | 6.89% |
| *Latam Svgn* | 6.26% | -1.95% | 1.43% | -1.81% | 2.51% |
| BAML EM CORP | 5.41% | 0.26% | 1.74% | 1.20% | 3.51% |
| *Asia Corp* | 3.92% | 0.46% | 1.12% | 1.42% | 6.51% |
| *EMEA Corp* | 6.18% | 0.96% | 3.91% | 3.10% | 2.39% |
| *Latam Corp* | 6.60% | -0.55% | 0.72% | -0.54% | 1.19% |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

BAML : Bank of America Merrill Lynch
Svgn : Sovereign
EM : Emerging Market
EMEA : Europe, Middle East, Africa

Corp : Corporate
IG : Investment Grade
HY : High Yield
Latam : Latin America

**Forecast figures are not a reliable indicator of future performance.**

# Market performance and forecasts

## Currencies

| | Performance YTD | Current | 3-month forecast | 6-month forecast |
|---|---|---|---|---|
| EUR/USD | -13.0% | 1.05 | 1.08 | 1.07 |
| USD/JPY | 1.3% | 121 | 122 | 125 |
| EUR/CHF | -12.0% | 1.06 | 1.08 | 1.08 |
| GBP/USD | -5.2% | 1.47 | 1.46 | 1.46 |
| EUR/GBP | -8.6% | 0.71 | 0.74 | 0.73 |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

## 10-year yield

| | YTD Total return (local currency) | Current | 3-month forecast | 6-month forecast |
|---|---|---|---|---|
| USA | 0.9% | 2.1% | 2.2% | 2.4% |
| GER | 3.1% | 0.3% | -0.2% | -0.2% |
| UK | 0.6% | 1.7% | 1.8% | 2.1% |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

## Commodities

| | Performance YTD | Current | 3-month forecast | 6-month forecast |
|---|---|---|---|---|
| Gold in USD | -2.8% | 1153 | 1200 | 1150 |
| Oil (Brent) in USD | -0.9% | 55 | 50 | 55 |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

## Equities

| | YTD Total return (local currency) | Current | 3-month forecast | 6-month forecast |
|---|---|---|---|---|
| S&P 500 | 0.2% | 2053 | 2150 | 2150 |
| DJ Euro Stoxx 50 | 16.5% | 3656 | 3600 | 3450 |
| Topix | 10.9% | 1560 | 1600 | 1650 |

Sources: Societe Generale Private Banking, Bloomberg, Datastream. Data as at 13/03/2015.

BAML : Bank of America Merrill Lynch
Svgn : Sovereign
EM : Emerging Market
EMEA : Europe, Middle East, Africa

Corp : Corporate
IG : Investment Grade
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