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and uncommon perspectives.

Barings Investment Luncheon

2016 outlook and strategy

21 January 2016

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18%* fall in global equity markets
The implication

- The key debate is which type of bear market we are experiencing:
  1) A "**non-recession driven bear market**" drops **26%** on average and last **5** months.
  2) A "**recession driven bear market**" drops **44%** on average and last **20** months.

- Our stance:
  – Barings' fundamental analysis currently points to scenario 1)

Source: DB Securities (text in italics) & Barings, January 2016
* : MSCI World equity market price index fell by 18% from the peak in May 2015 to the recent lows in USD terms

Highlights of Barings' 2016 outlook

Despite current sell-off, fundamentals are still relatively sound

- OECD and Chinese economies are recovering modestly
- Corporate earnings are expected to recover modestly in 2016
- DM equity valuations are relatively high, but more attractive than bonds/ cash
- EM equity valuations are cheap, but need more signs of growth surprises

But the market is only focusing on risk events at present!

Source: Barings, January 2016

Current investors' sentiment

Risks are at the forefront of the global investors' mind

- **China's "growth recession"**? Russia and Brazil are already in recession… **Will China follow, or has it stabilised**?
- **Fed Fund Rate hikes**: **2 or 4 hikes** in 2016? Will the **strong USD** continue, with negative impact on EM and commodities?
- Would **China's 'growth recession'** and **US's monetary tightening push the world into a recession?**
- **'Bubble' DM valuations versus stagnant earnings growth:** Are current **high valuations justified in the DM equity** universe? Are **EM valuations** really cheap?

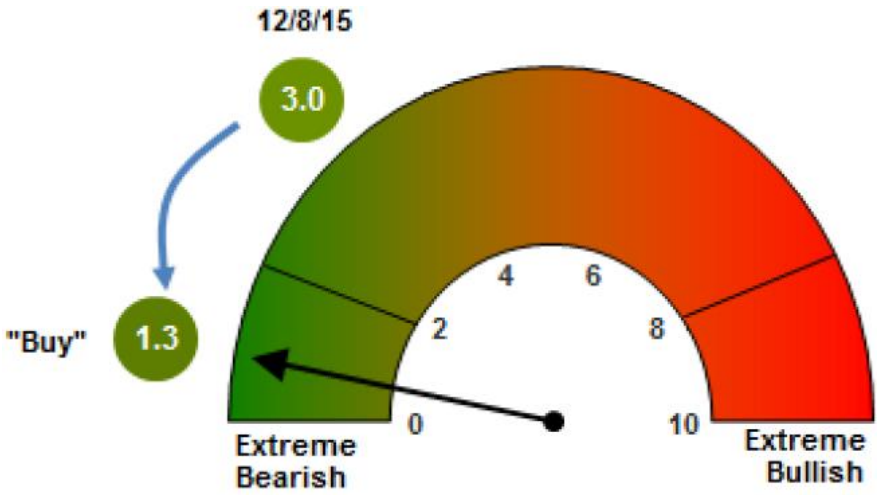
Source: Barings, January 2016

Global investors' sentiment

From "cautious" back to "bearish"

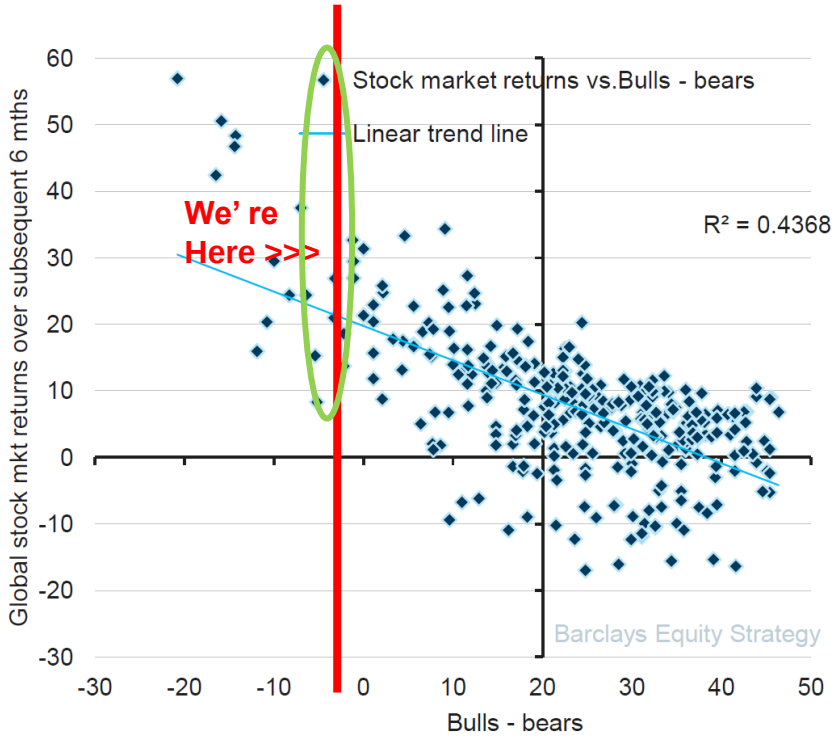
The Bull and Bear Index

[current indicator is 1.3 (scale from 0-10)]



Global equity market returns 6 months out, at various sentiment levels

(2009 to date)



An investor who buys in the "extreme bearish" zone has tended to make out-sized profits in the following 6-12 months

Source: **(left) BofAML Global Investment Strategy**, EPFR Global, 6 January 2016; **(right) Barclays Research**, Investors Intelligence, September 2015
Note: This correlation has been performed using data since 2009. NB: Past performance not necessarily indicative of future results.

Playing it safe

Where are global investors' long and short bets?

- **Long/ overweight USD**, Short/ underweight EM currencies and commodities
- **Long/ overweight DM assets**, Short/ underweight China/ Asia/ EM assets
- **Long/ overweight Healthcare/ Internet/ Consumer**, Short/ underweight Energy/ Materials

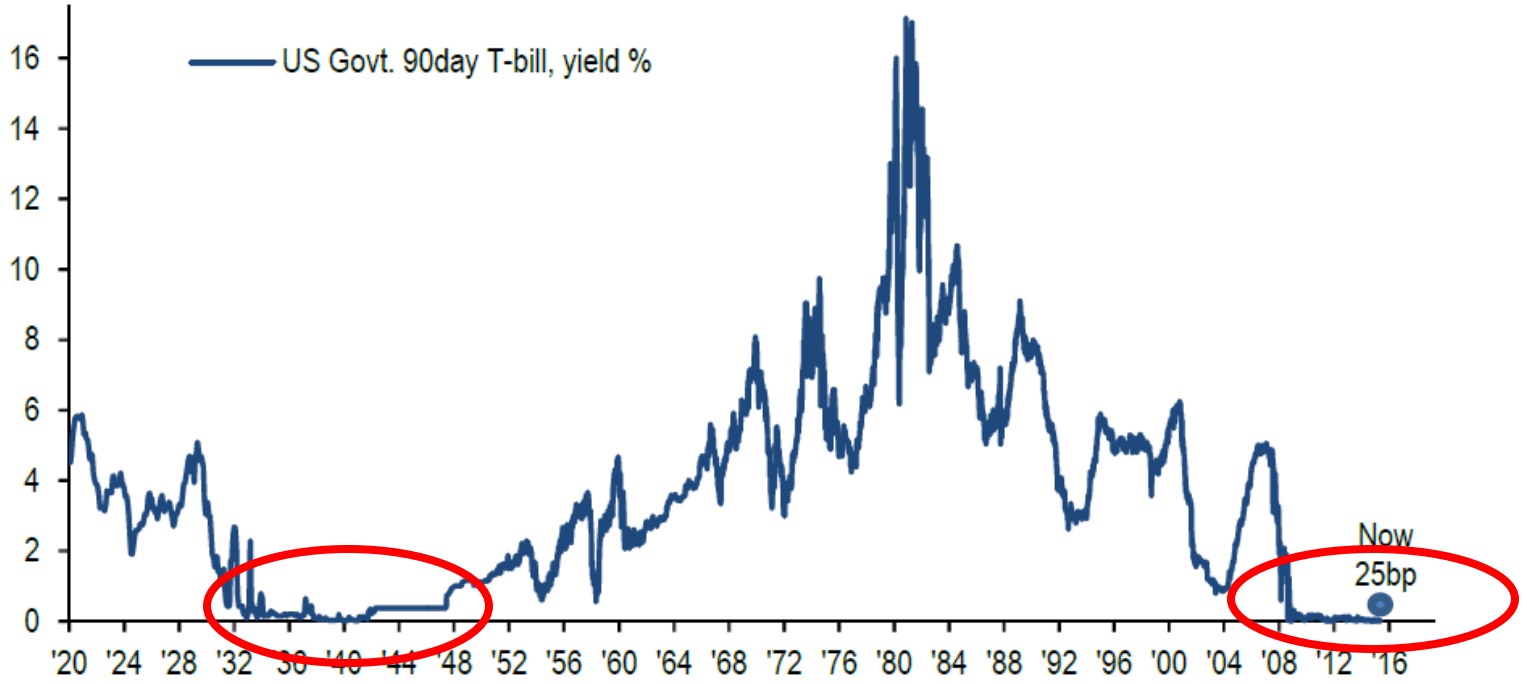
Source: BoAML and Barings, October-November-December 2015

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History of Fed Fund Rates

When and what level will they peak?

US short rates: still at "depression" levels !



The most important guessing game in the coming 2 years!

Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg, Global Financial Data (GFD), 17 December 2015

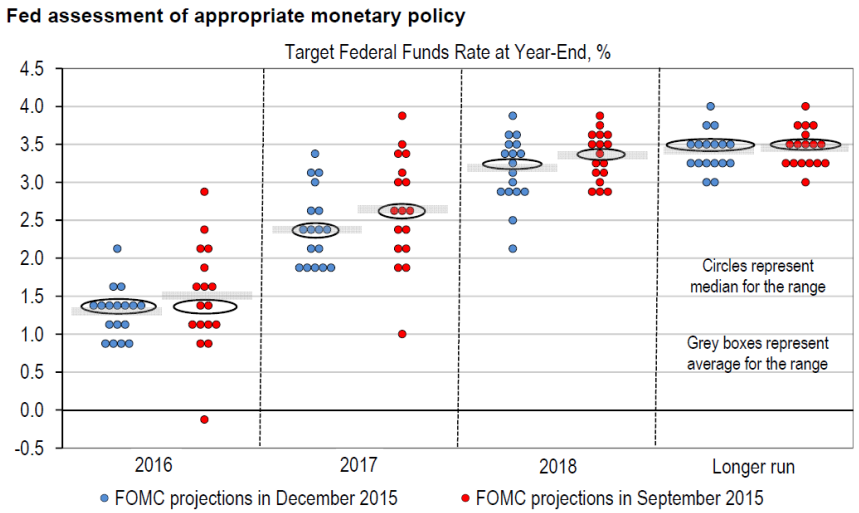
Fed Fund Rates
What level will they peak?

Based on the Fed Fund Futures market*

- Dec 2015: 0.25%
- Mar 2016: 0.40%
- Jun 2016: 0.51%
- Dec 2016: 0.69%
- Dec 2017: 1.05%

Gradual 'normalisation' of rates, not severe tightening!

What US Fed Board of Directors are predicting **



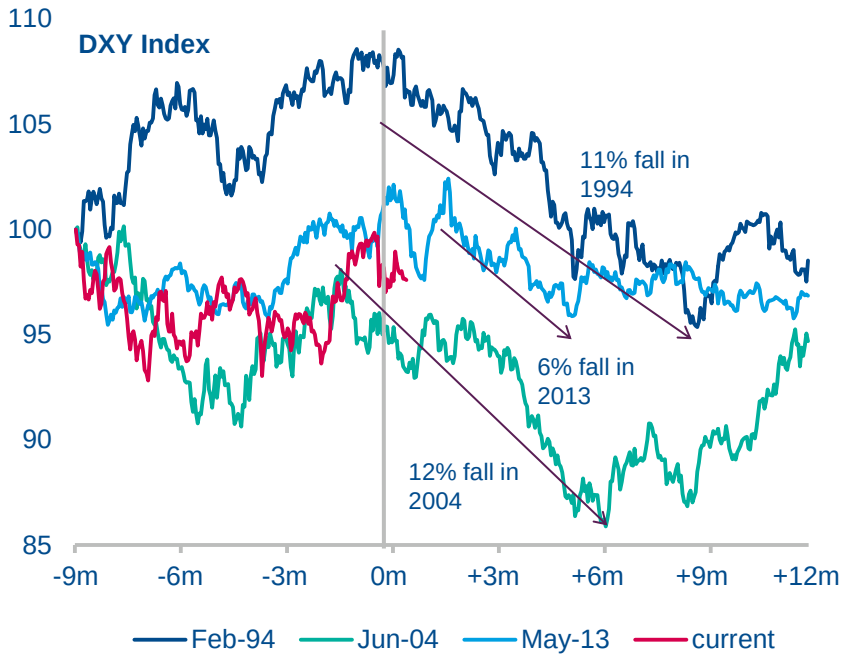
Much more aggressive rate hikes, ie, a more 'classical tightening' phase

* FF rate futures – Source: Bloomberg, Barings, January 2016
** Fed assessment of appropriate monetary policy – Source: Federal Reserve, HSBC, December 2015

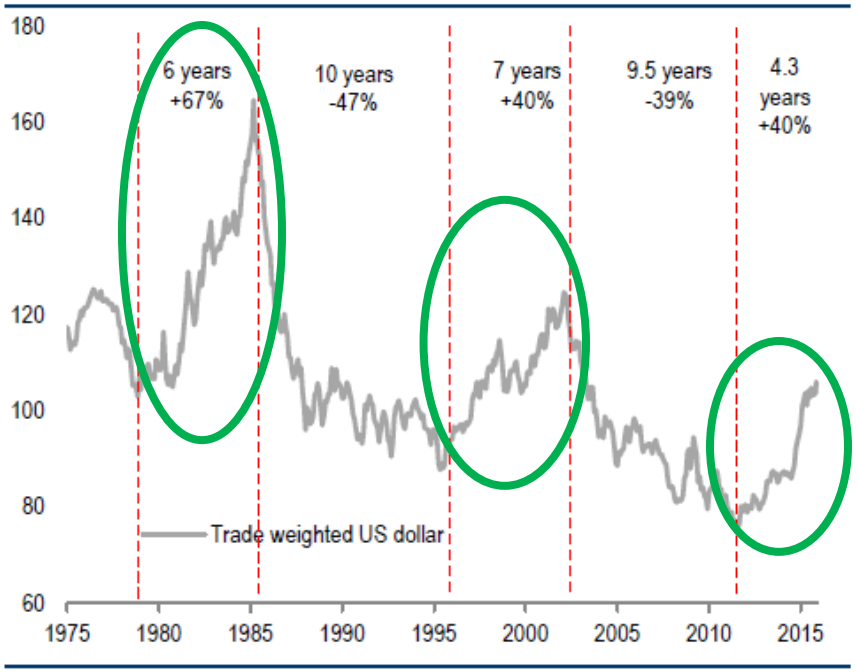
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The strong US Dollar
When will it peak?

USD vs DXY (trade-weighted US dollar): Before and after Fed tightening



Is the US Dollar rally nearing its peak, and about to resume its long-term downtrend ?

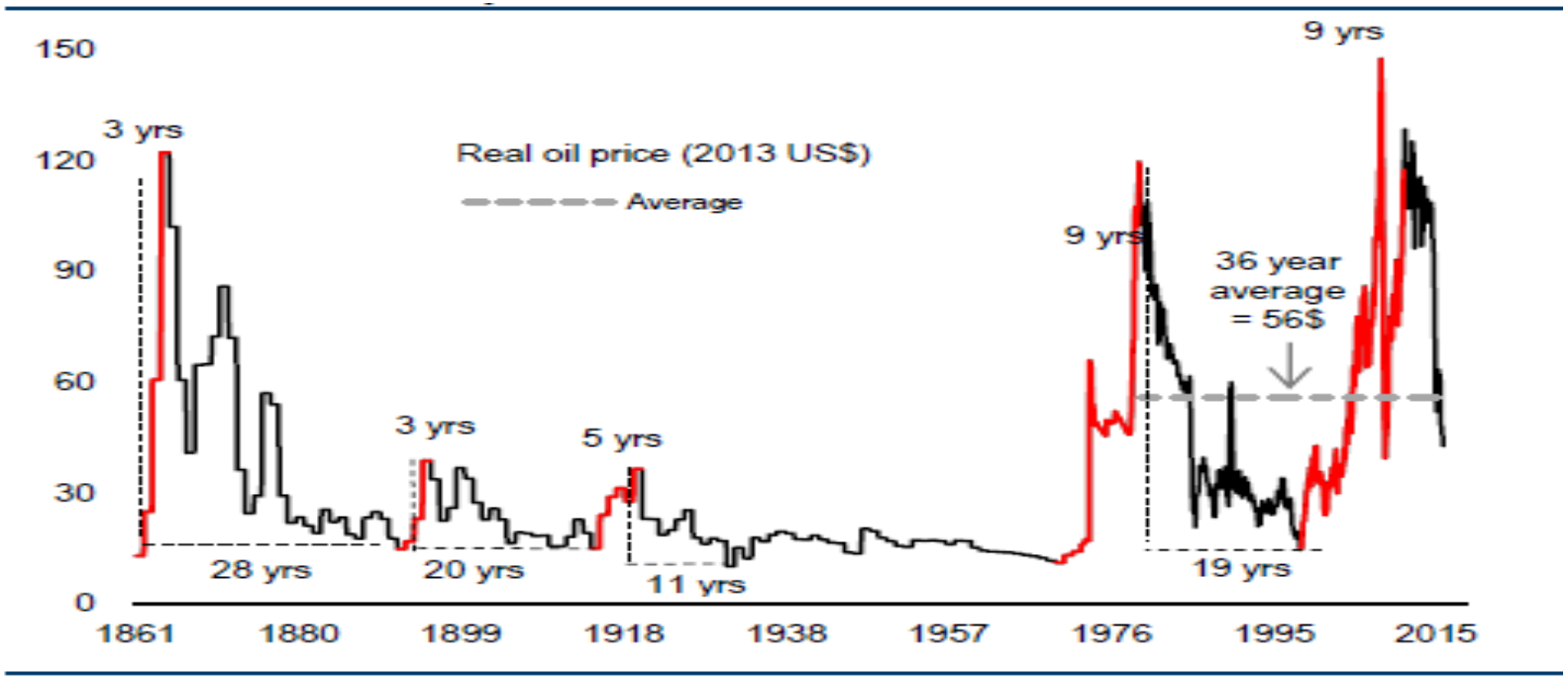


Fundamentally, long-term, the USD is a weak currency. But its bear market rallies have been dramatic!

USD vs DXY – Source: MSCI, Credit Suisse, January 2016. Trade weighted US dollar - Sources: Thomson Reuters and Credit Suisse research, November 2015

Oil Prices
Where is the "true' bottom?

Would the oil price bottom out at USD 20/bbl ?



Apart from major OPEC producers, few can survive with the oil price trading below USD 30/bbl!

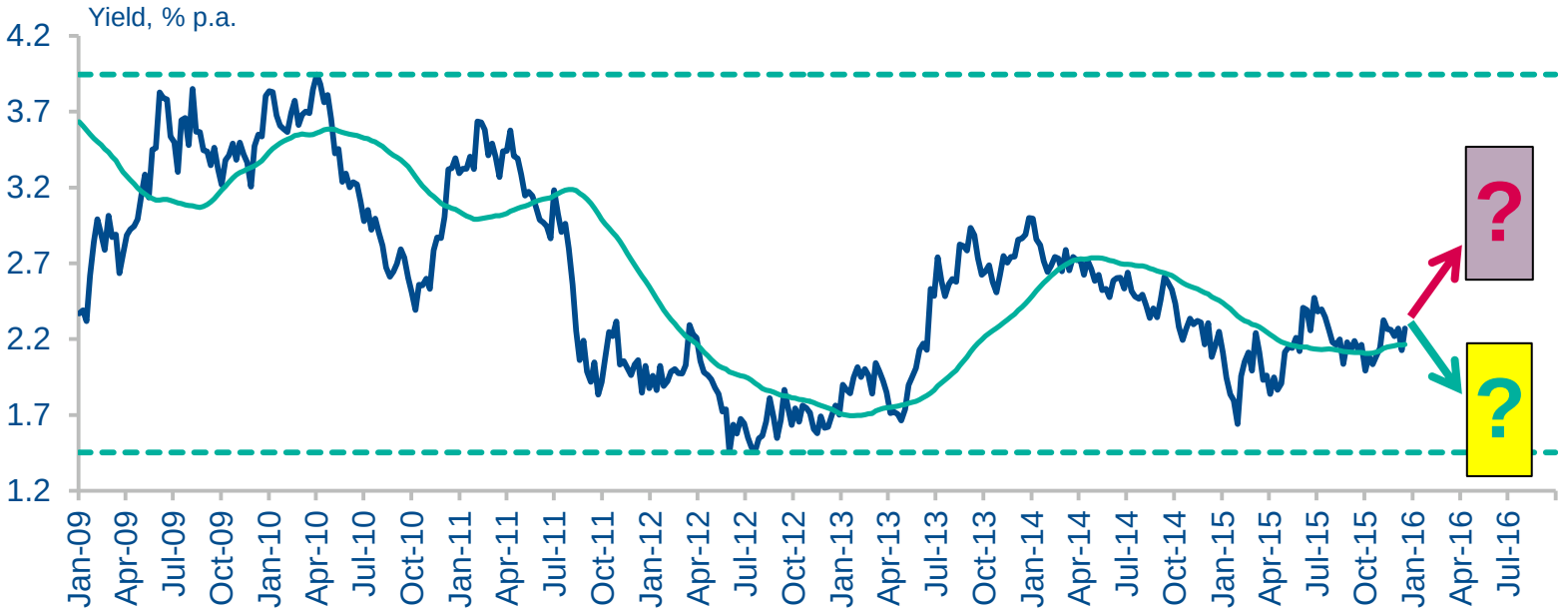
Sources: Thomson Reuters and Credit Suisse research, November 2015

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US Treasuries

Has the long end discounted the 'normalised' US economy?

US 10 Year Govt Bond Yield



Source: Bloomberg, weekly data from January 2009 to December 2015

Trading at 2.10% p.a., the answer is "Yes, gradually".
At 2.50 to 3% p.a., 10 year Treasuries is deemed to offer good long-term value

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Global economic and interest rate outlook:

- Is **China in a "growth recession"**?... or **steady growth**?
- Could the **weak global manufacturing sector** and **Fed Fund rate hikes** cause a global recession?

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Global economic growth in 2016

The consensus is becoming more realistic

	GDP Growth (%)					
	2011	2012	2013	2014	2015F	2016F
World	**3.5**	**2.6**	**2.6**	**2.8**	**2.6**	**2.6**
US	1.6	2.2	1.5	2.4	**2.4**	**2.1**
Eurozone	1.7	-0.8	-0.2	0.9	**1.5**	**1.7**
Japan	-0.4	1.7	1.6	-0.1	**0.7**	**1.0**
China	9.0	7.7	7.7	7.3	**6.9**	**6.6** (too high?)
Asia ex Japan	7.5	6.4	6.6	6.4	**6.0**	**5.8** (too high?)
Global Emerging	6.5	5.0	5.1	4.6	**3.8**	**3.9** (too high?)

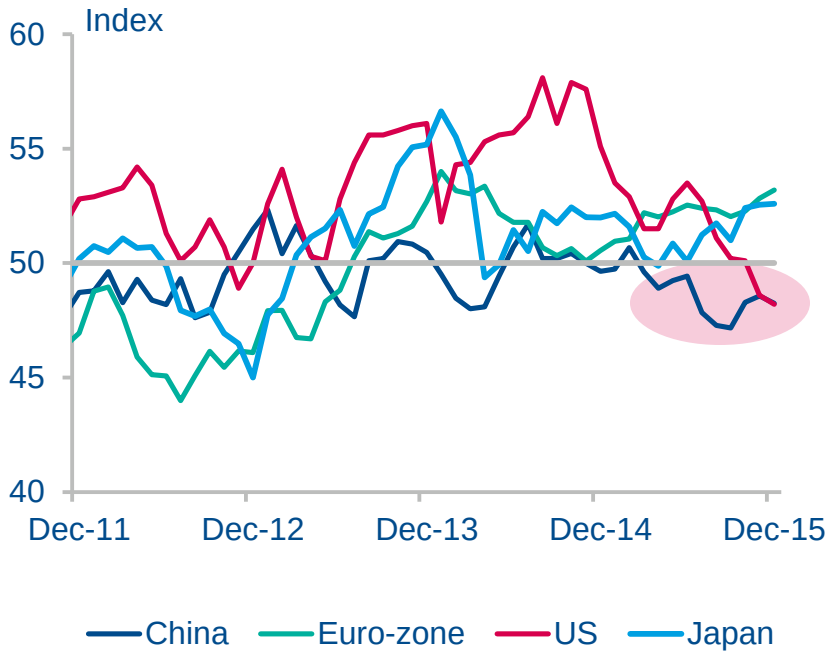
Source: JP Morgan, January 2016

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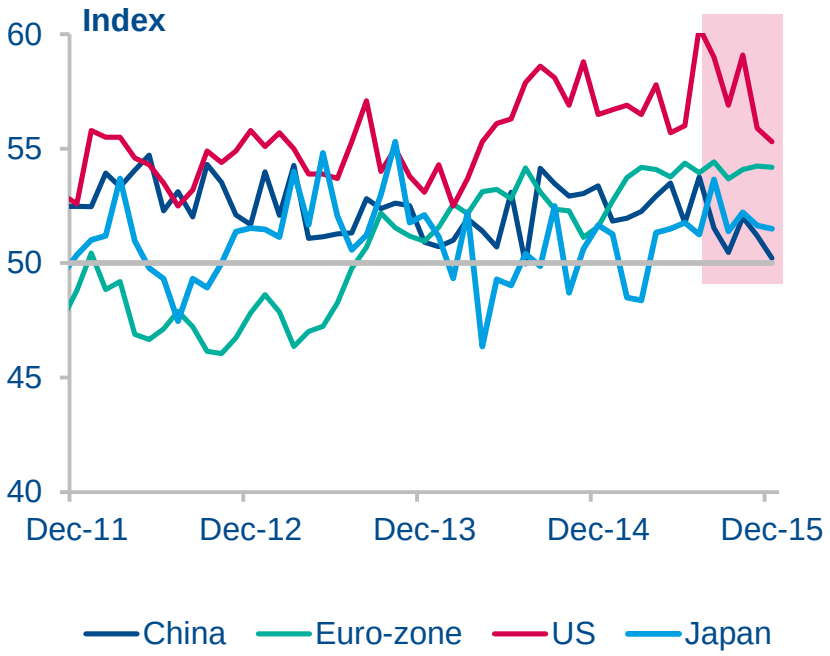
Global economy

Still weak manufacturing…services is more resilient!

Manufacturing PMI



Services PMI

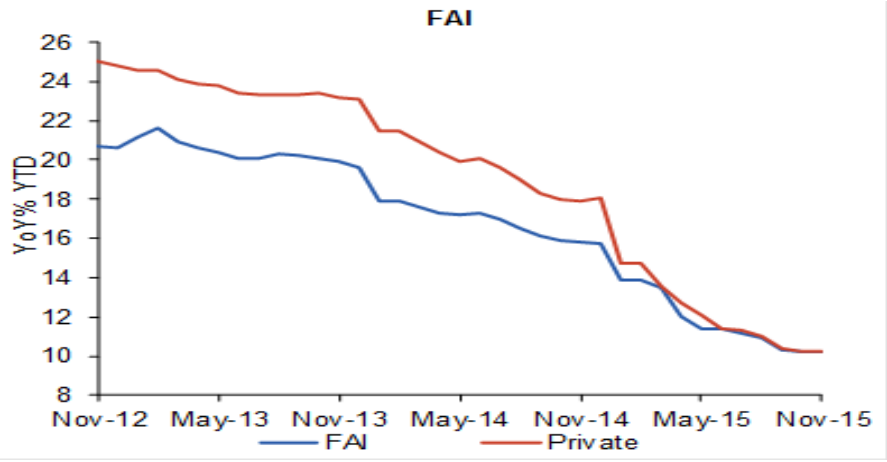


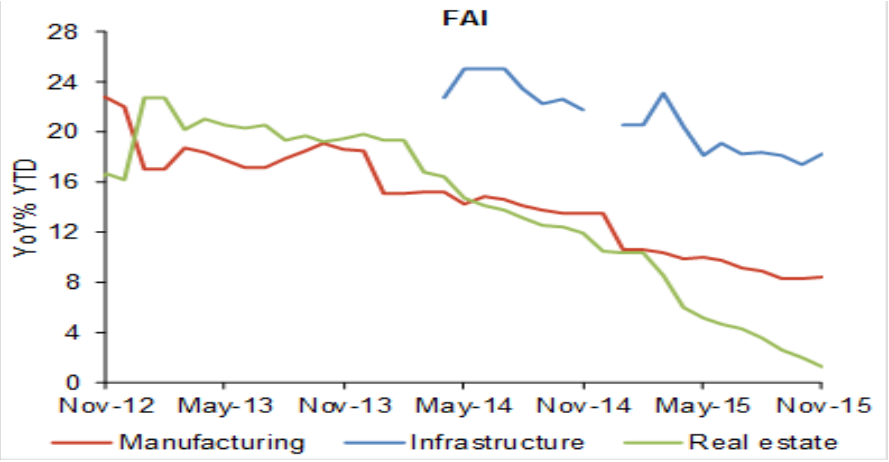
Recent deterioration of China's Caixin (private-sector) PMI indicators suggest that the economy needs more fiscal and monetary stimuli

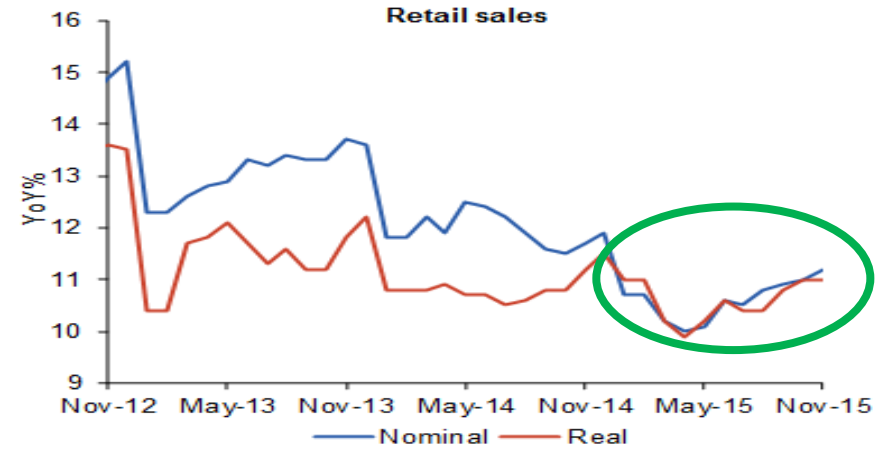
Source: Haver Analytics, Deutsche Bank Research, January 2016

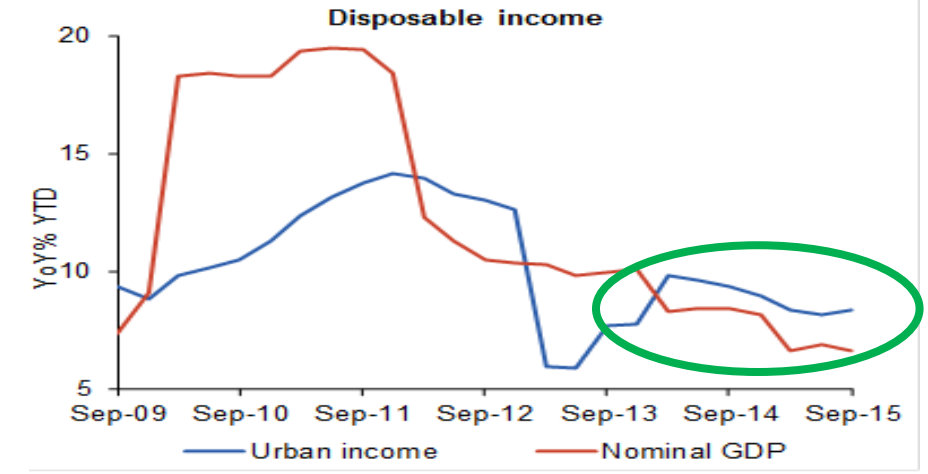
Chinese Economy

Weak FAI/IP/Manufacturing …. Consumption is stronger









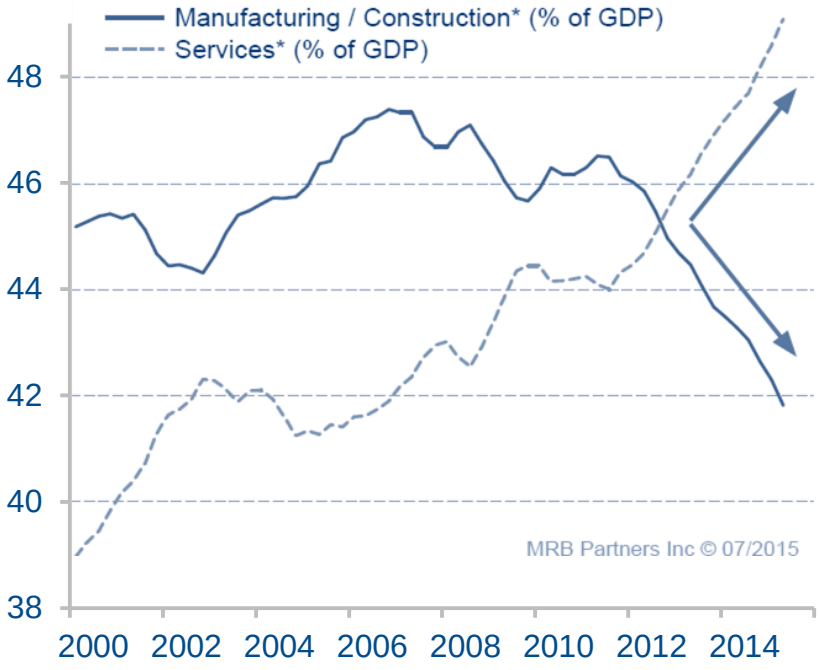
Can consumption and services continue to power China's economic growth?

Source: CEIC, Mizuho research, December 2015

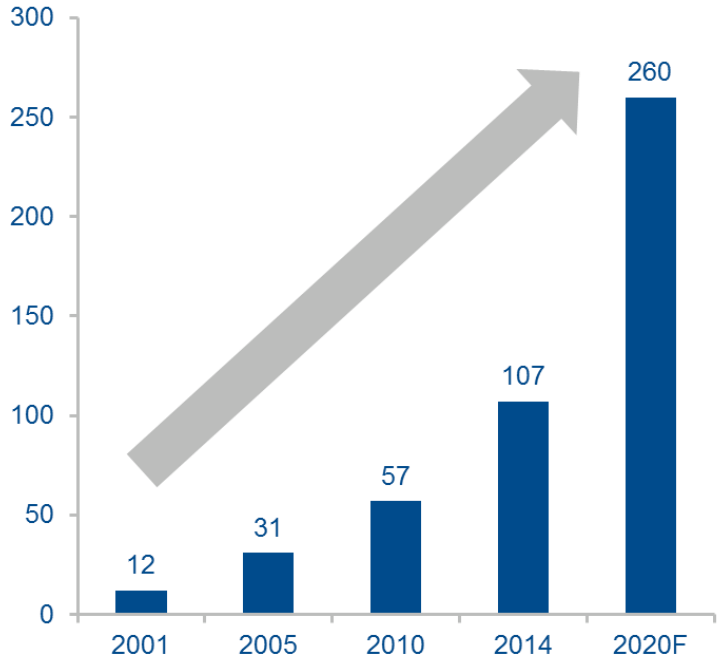
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Chinese consumption
China's economic transformation

China's GDP composition: Services has become the key driver!



Chinese tourism: Booming** !



China is naturally growing from Emerging to Developed, but the transitional phase has caused short-term growth pains!

* Source: China National Bureau of Statistics, MRB Partners, July 2015
** Richemont Marketing Services, HSBC, December 2015

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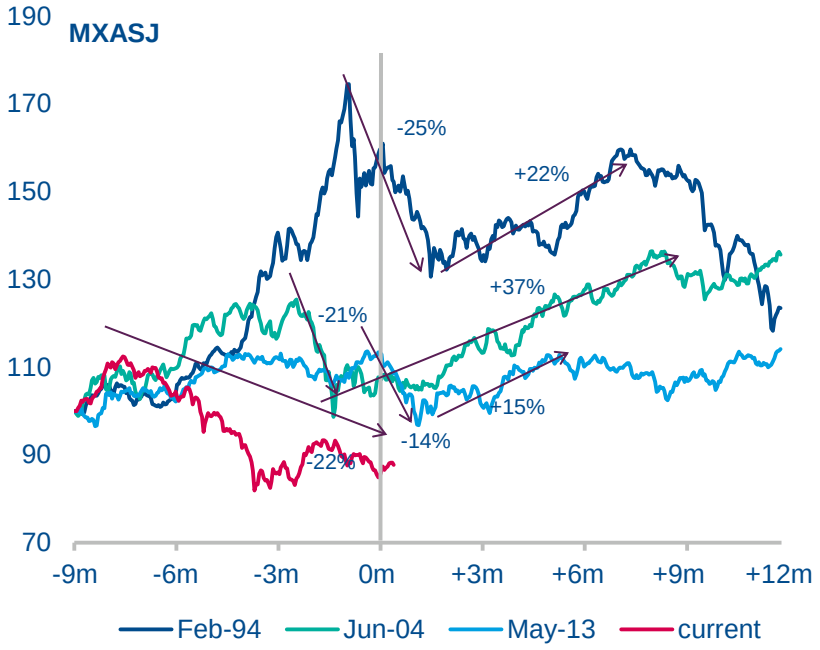
Global equity markets:

- **Impact of FFR hikes** on Equity markets?
- **Impact of QE programs** on DM Equity markets?
- Will the **cheap Chinese/ Asian/ EM valuations attract investors**?

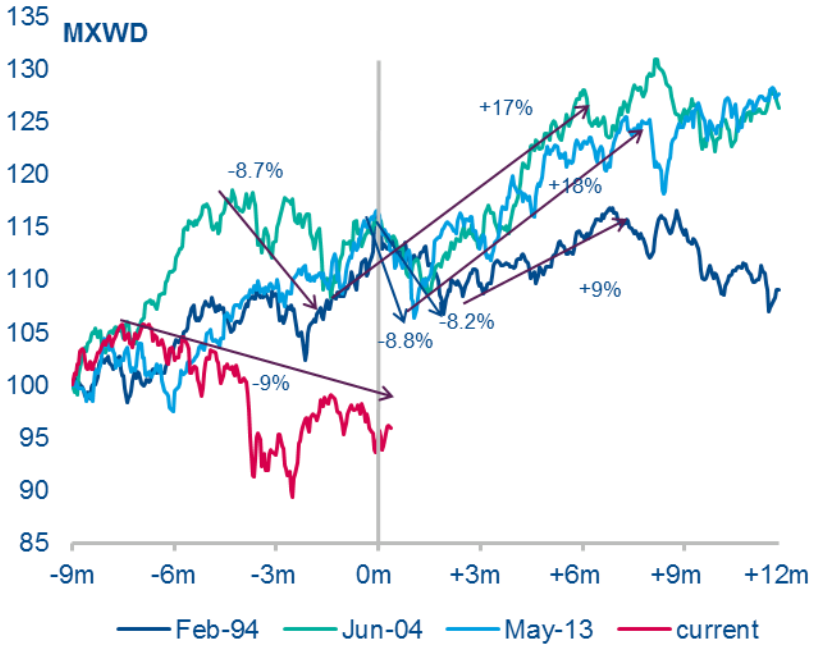
Impact of US Fed Rate hikes on equity markets

Correction, then back to trend

MSCI Asia ex Japan performance: around Fed tightening



MSCI World performance: around Fed tightening



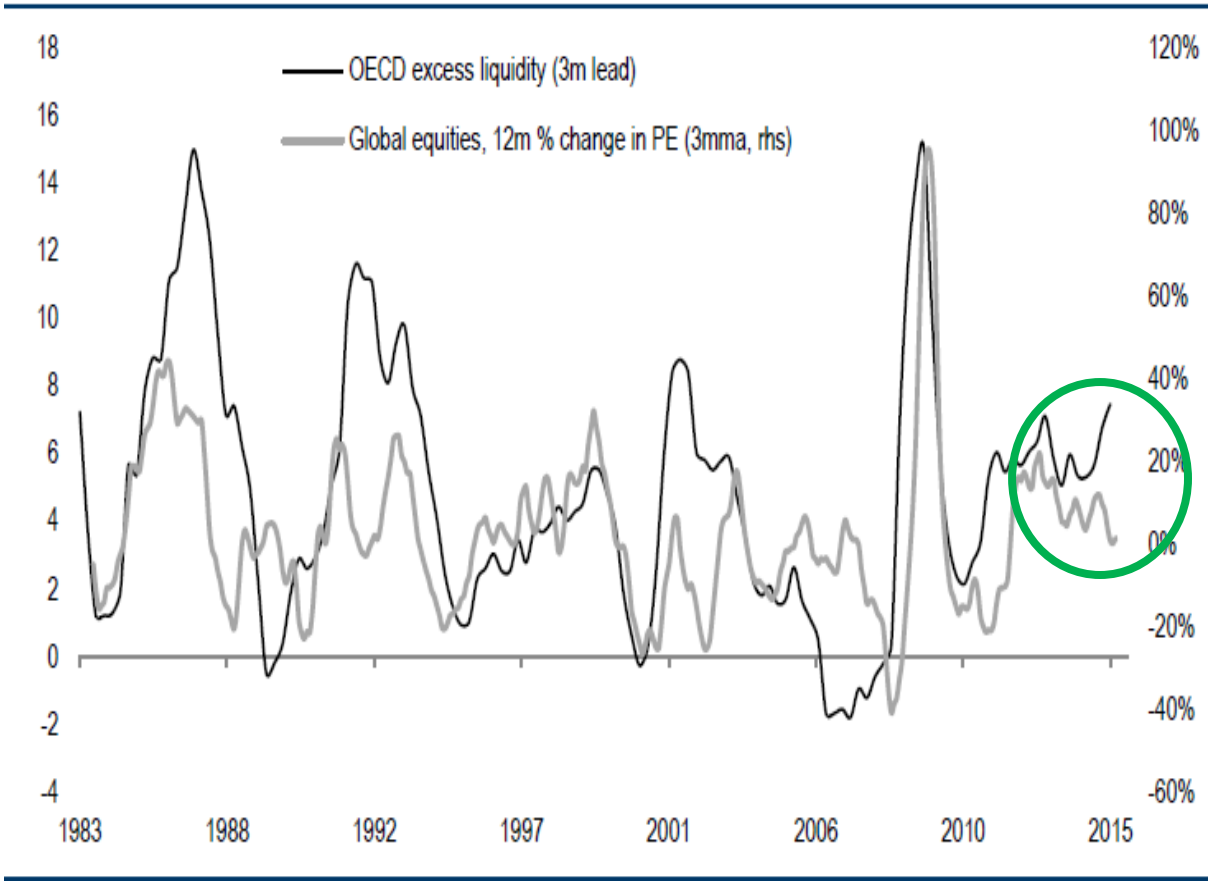
Correction was short-lived

Source: MSCI, Credit Suisse, January 2016.

Global equities

Why it still pays to be invested

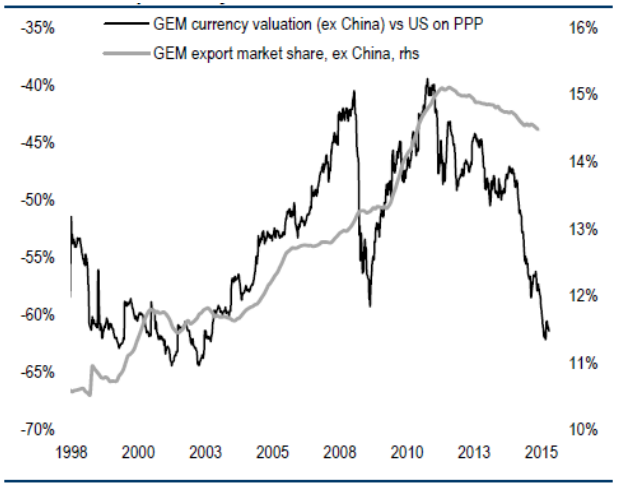
Global excess liquidity is consistent with a potential re-rating of global equities of around c35%?



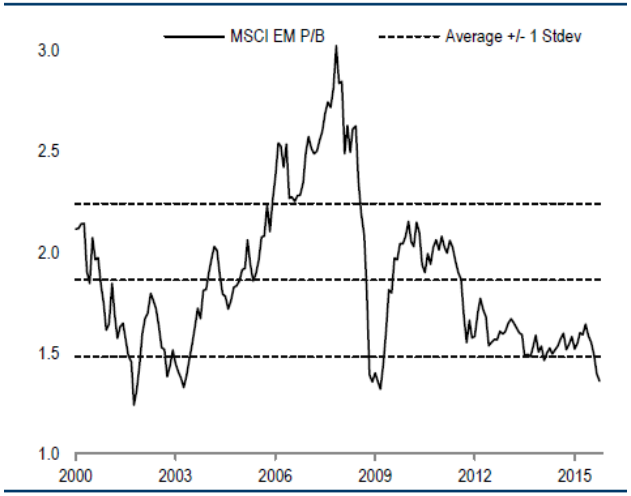
Sources: Thomson Reuters and Credit Suisse research, November 2015

Global Emerging Equities
The case in favour

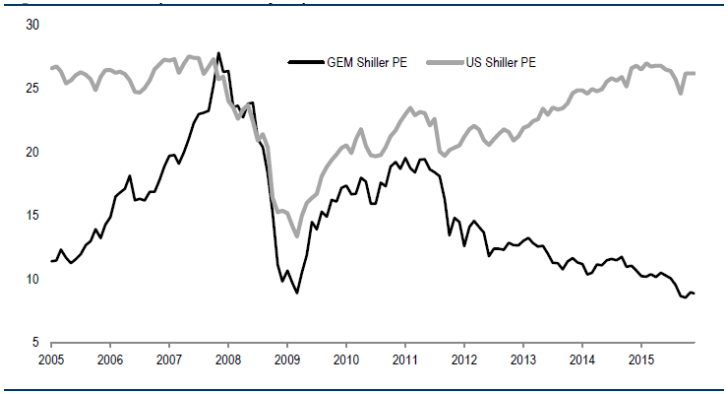
Against PPP, GEM currencies (ex-China) are now as cheap as they were in 2002



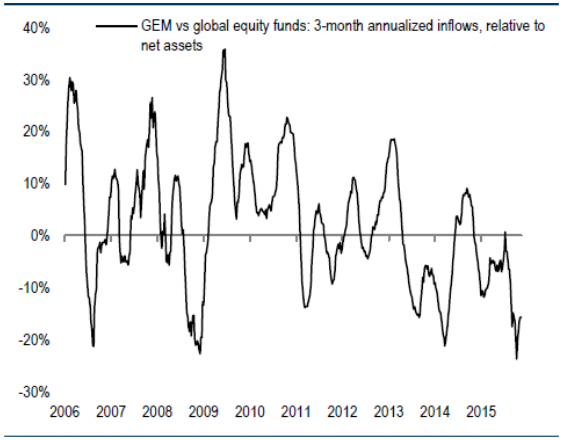
The P/B of emerging markets in absolute terms is near 2009 lows



GEM equities are very depressed on Shiller P/E relative to the US

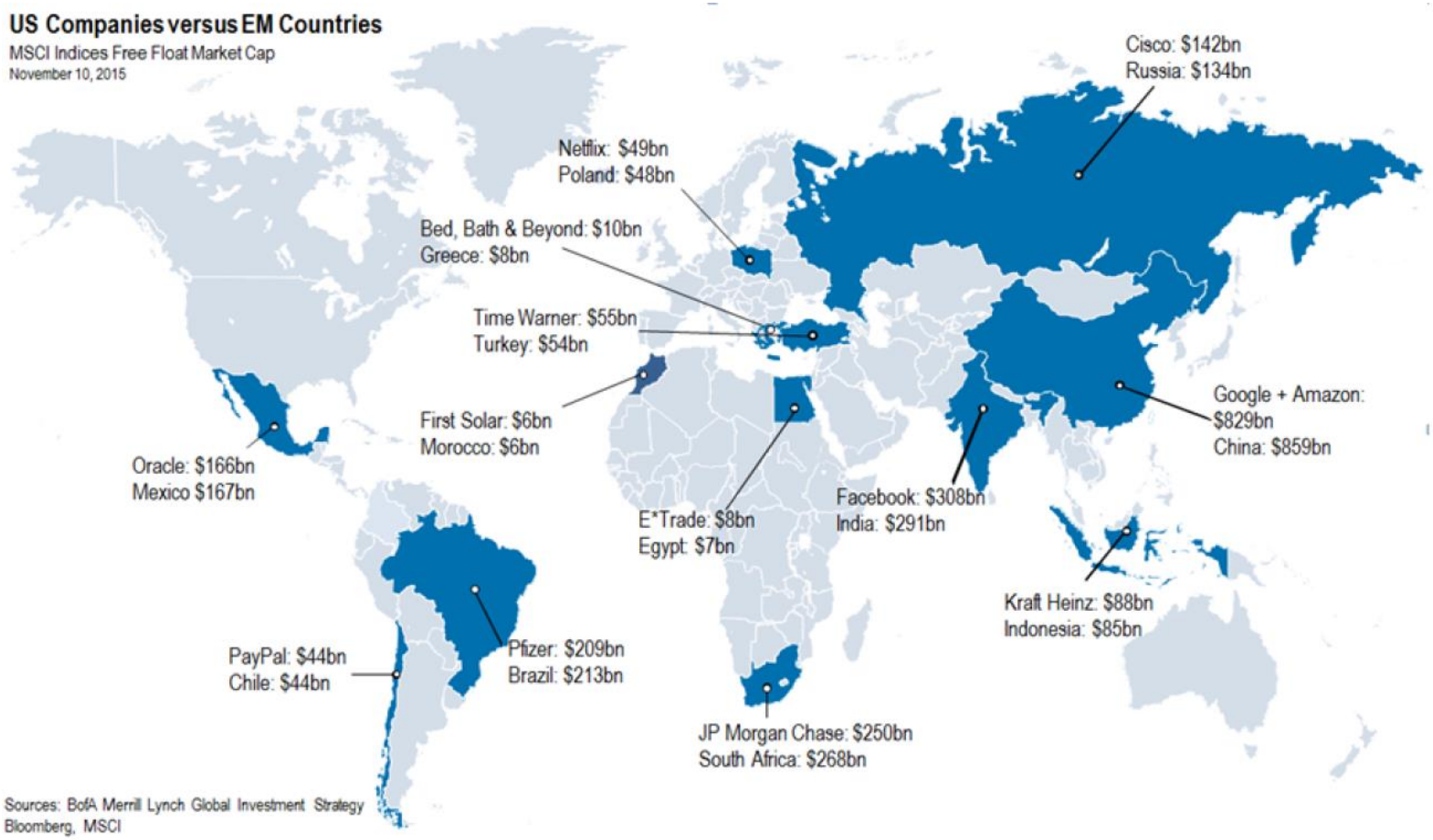


Outflows out of GEM equity funds had reached extreme levels



Sources: Thomson Reuters, Credit Suisse research and EPFR, November 2015

The sublime and the ridiculous
Value of US companies versus EM markets



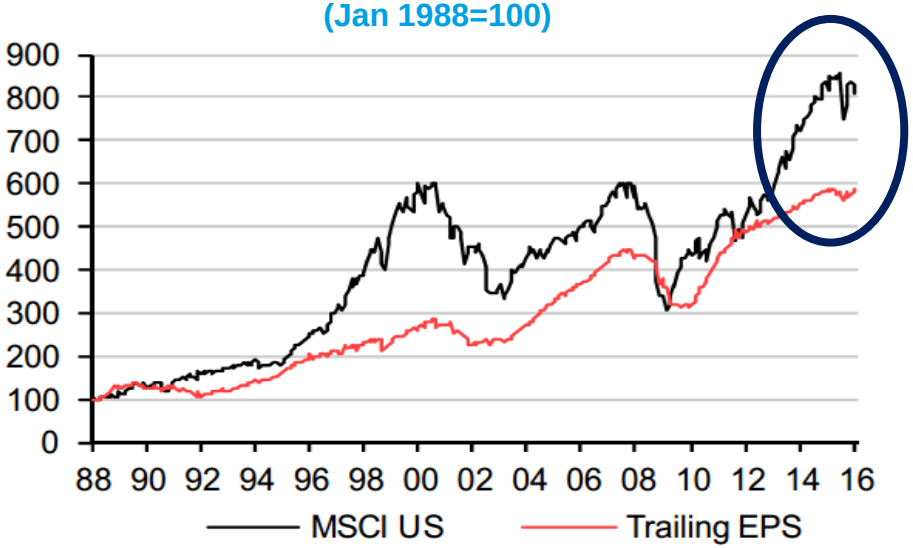
Is Facebook worth as much as the whole of the Indian stock market?

Source: BofA Merrill Lynch Global Investment Strategy, MSCI, November 2015

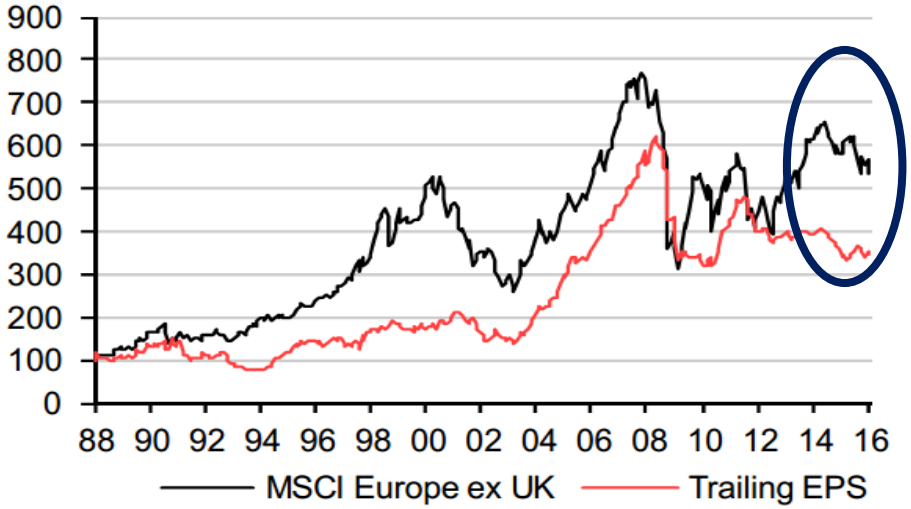
Share price performance versus EPS growth

QE-fuelled or Not?

US price and EPS index
(Jan 1988=100)



Europe ex UK price and EPS index
(Jan 1988=100)



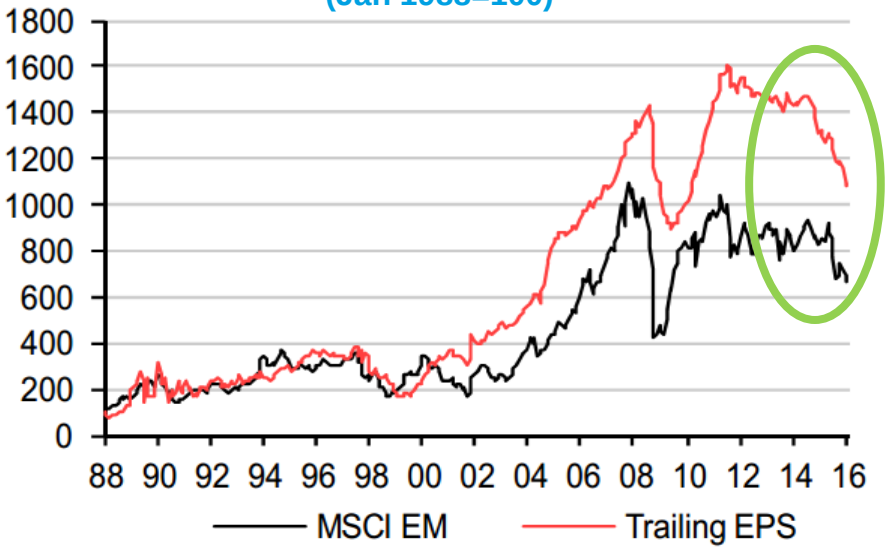
Share prices are ahead of earnings: boosted by QE?

Source: MSCI, IBES, Thomson Reuters Datastream, HSBC, January 2016

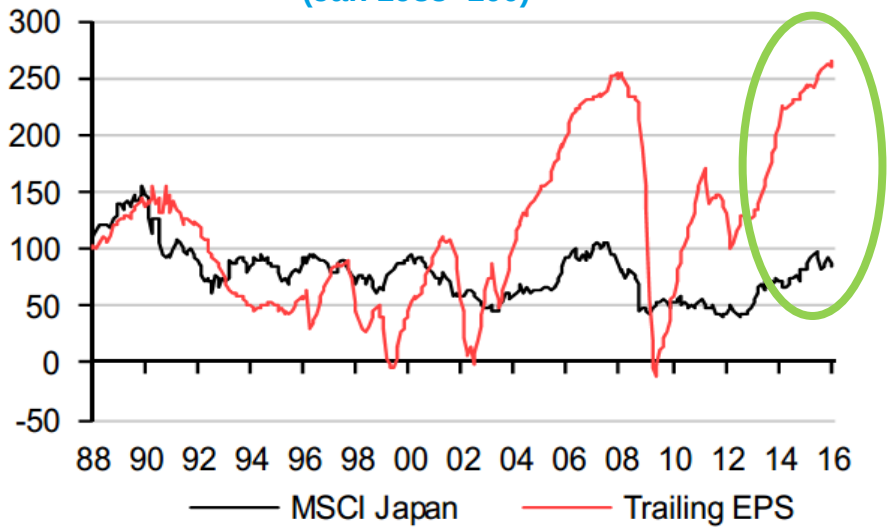
Share price performance versus EPS growth

Impacted by China growth slowdown and strong USD ?

EM price and EPS index
(Jan 1988=100)



Japan price and EPS index
(Jan 1988=100)



Share prices are below earnings:
Affected by China growth and strong USD (esp. EM)

Source: MSCI, IBES, Thomson Reuters Datastream, HSBC, January 2016

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Global and EM/ Asian equity markets

Earnings growth forecasts and valuations

	P/E (x)		Div. Yield (%)	P/BV (x)	Earnings growth (%)				ROE (%)
Country	Current Trailing	12m fwd	Current Trailing	Current Trailing	2013	2014	2015E	2016E	2016E
Global	15.9	14.8	2.5	2.0	8.1	4.3	(0.5)	7.0	12.8
USA	16.4	15.2	2.0	2.6	8.4	5.5	(0.0)	7.3	16.0
Europe	15.6	14.7	3.4	1.7	(5.4)	1.4	(1.9)	5.9	11.5
Emerging Markets	12.1	11.2	2.9	0.9	19.3	(5.5)	(3.1)	7.6	8.1
India	18.6	15.8	1.5	3.2	14.4	(6.1)	11.0	17.6	16.7
China	9.9	9.1	3.1	1.5	8.3	3.0	2.9	8.5	13.7

As most of the reduction in equity risk premia in DM Markets has occurred, delivery of earnings and EPS revisions will be their key driver.

For Asia/EM Markets, it has more to do with their equity risk premium: will it fall if China continues to reflate?

Source: I/B/E/S, MSCI, J.P. Morgan estimates, January 2016

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