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What's next in the world?

Barings Asia Regional Conference 2015

October 2015

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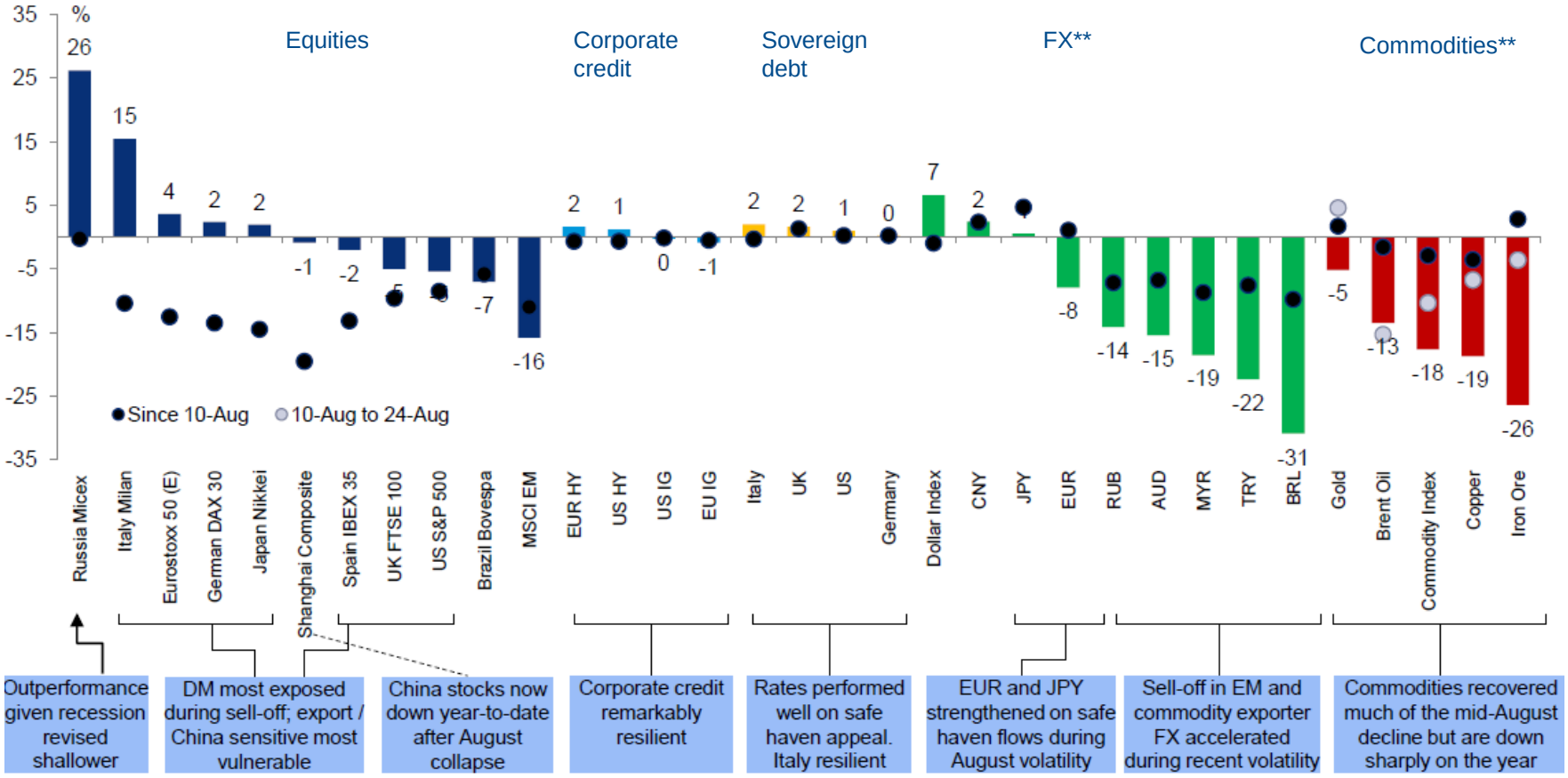
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Global asset classes

2015 – YTD returns (in local currency terms)

Total returns* (local currency, YTD to 4 September 2015)



Developed markets equities led, emerging markets fell.

USD still very strong versus emerging currencies … commodities still weak.

Note: (*) Total return accounts for both income (interest or dividends) and capital appreciation. (**) FX, Commodities are spot returns.
Source: Bloomberg Finance LP, Deutsche Bank Research, as of 4 September 2015

Risks
Fear is everywhere

- **Fed Fund Rate hike**: Timing of first hike? Will the tightening be gradual or more aggressive than current market expectations? Will the strong USD trend continue to inflict pain on emerging markets and commodities?

- **China (and emerging markets) GDP slowdown/ recession**: Russia and Brazil already in severe recession … is China next? Will BRIC push the world into a recession?

- **'Bubble' valuations**: Global bonds, A-shares, US equity market and 'New Economy' sectors (social media, biotech): how badly will it end?

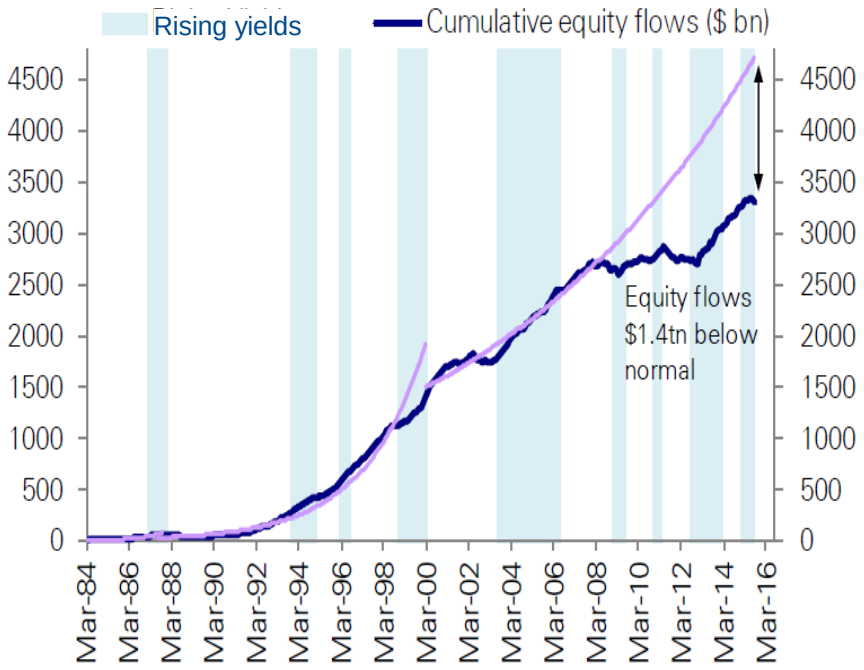
Playing it safe (1)
Where are global investors' long and short bets?

- **Long bonds/ cash**, short equities
- **Long developed markets**, short China/ Asia/ emerging markets
- **Long USD**, short emerging markets currencies and commodities
- **Long Japan**, short Asia
- **Long healthcare/ internet**, short energy/ materials

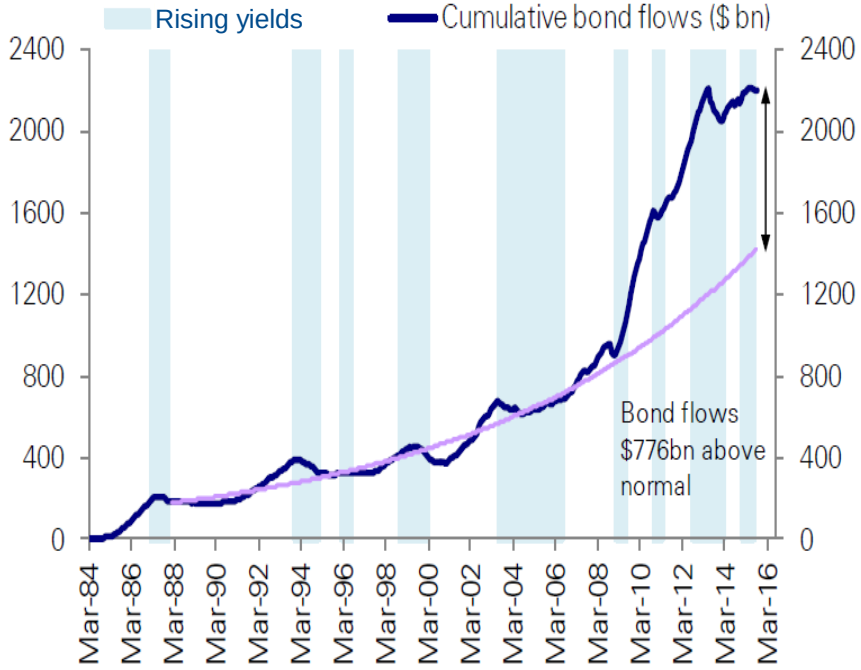
Fear is palpable!

Playing it safe (2)
Overweight bonds … cautious on equities

End investors are massively underweight equities…



…and overweight bonds

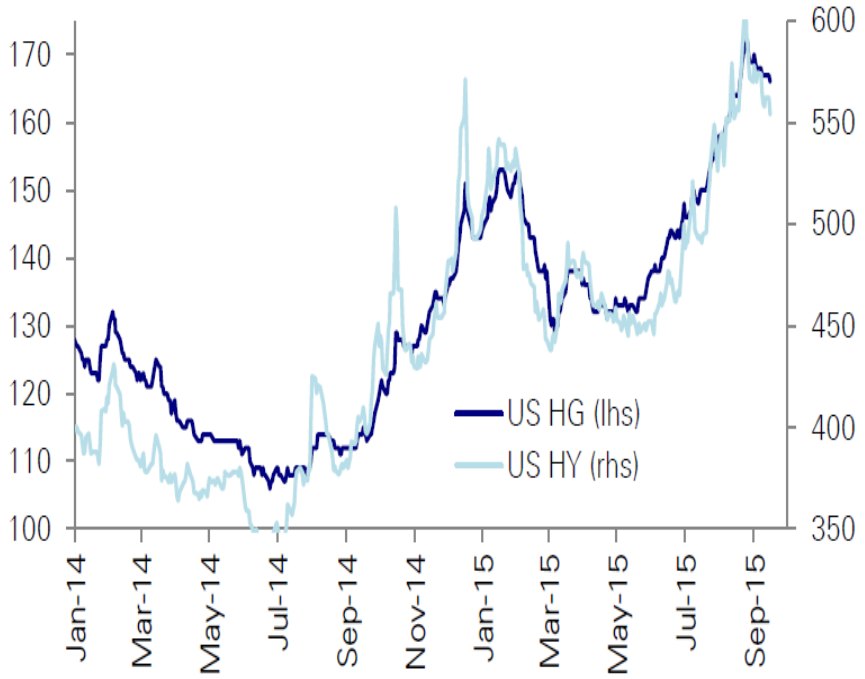


Very slow global growth/ recession being priced in?

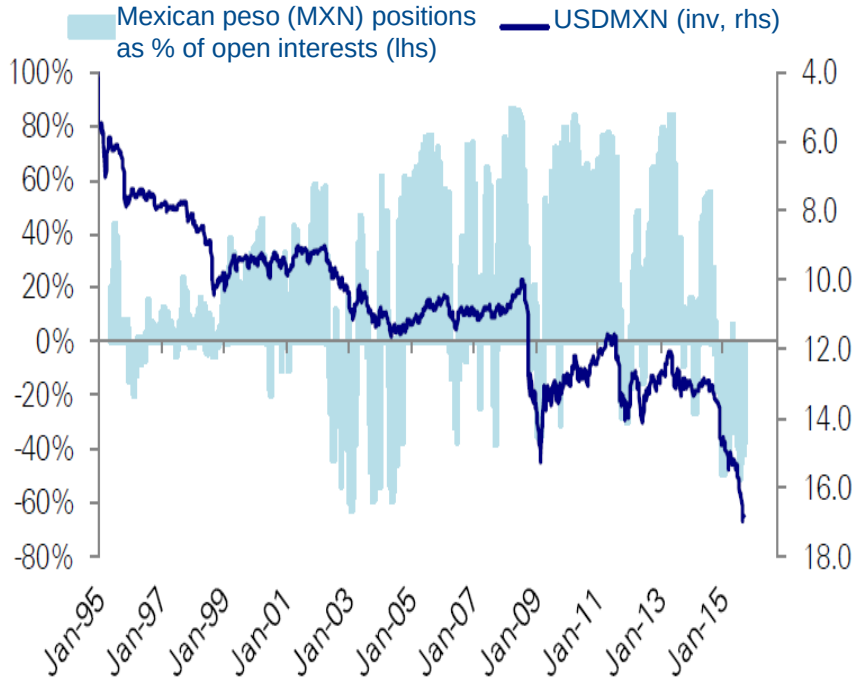
Source: Deutsche Bank, as at September 2015

Playing it safe (3)
Overweight OECD bonds and equities ….

High grade and high yield spreads to treasury bonds



Short positioning in emerging markets FX

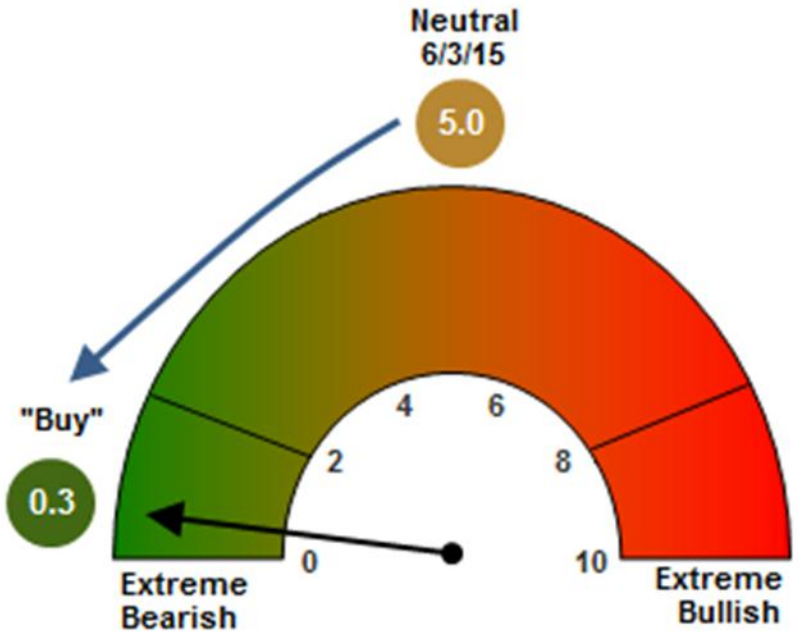


… and avoiding credit, China/ Asia/ emerging markets …

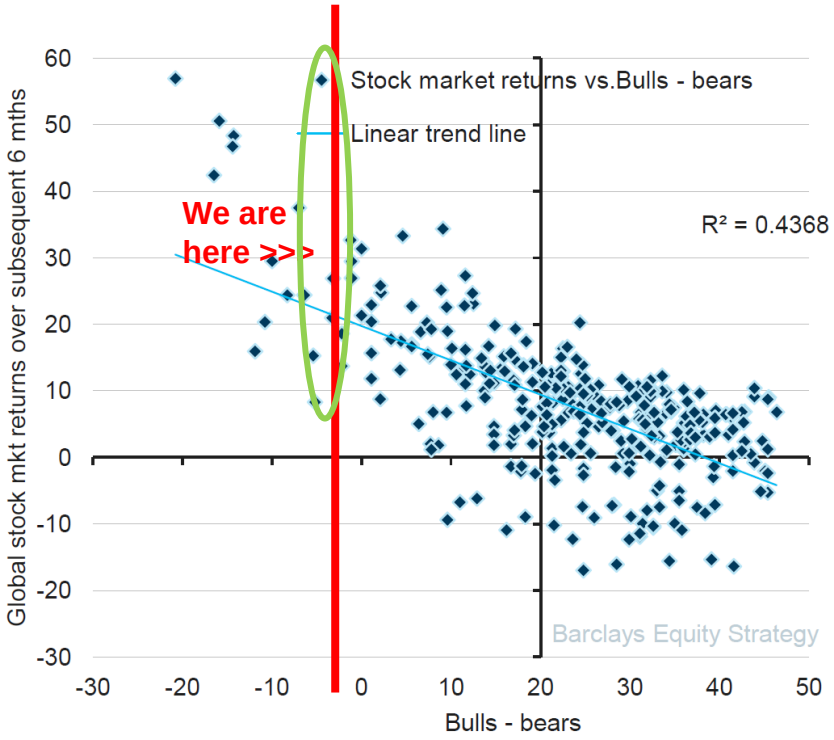
Source: Factset, CFTC, Haver, Deutsche Bank, as at September 2015

Global market sentiment (1)
As bearishness rises: “contrarian buy” signal nearing?

The Bull and Bear Index
(scale from 0-10)



Global equity market returns six months out, at various sentiment levels
(2009 to date)



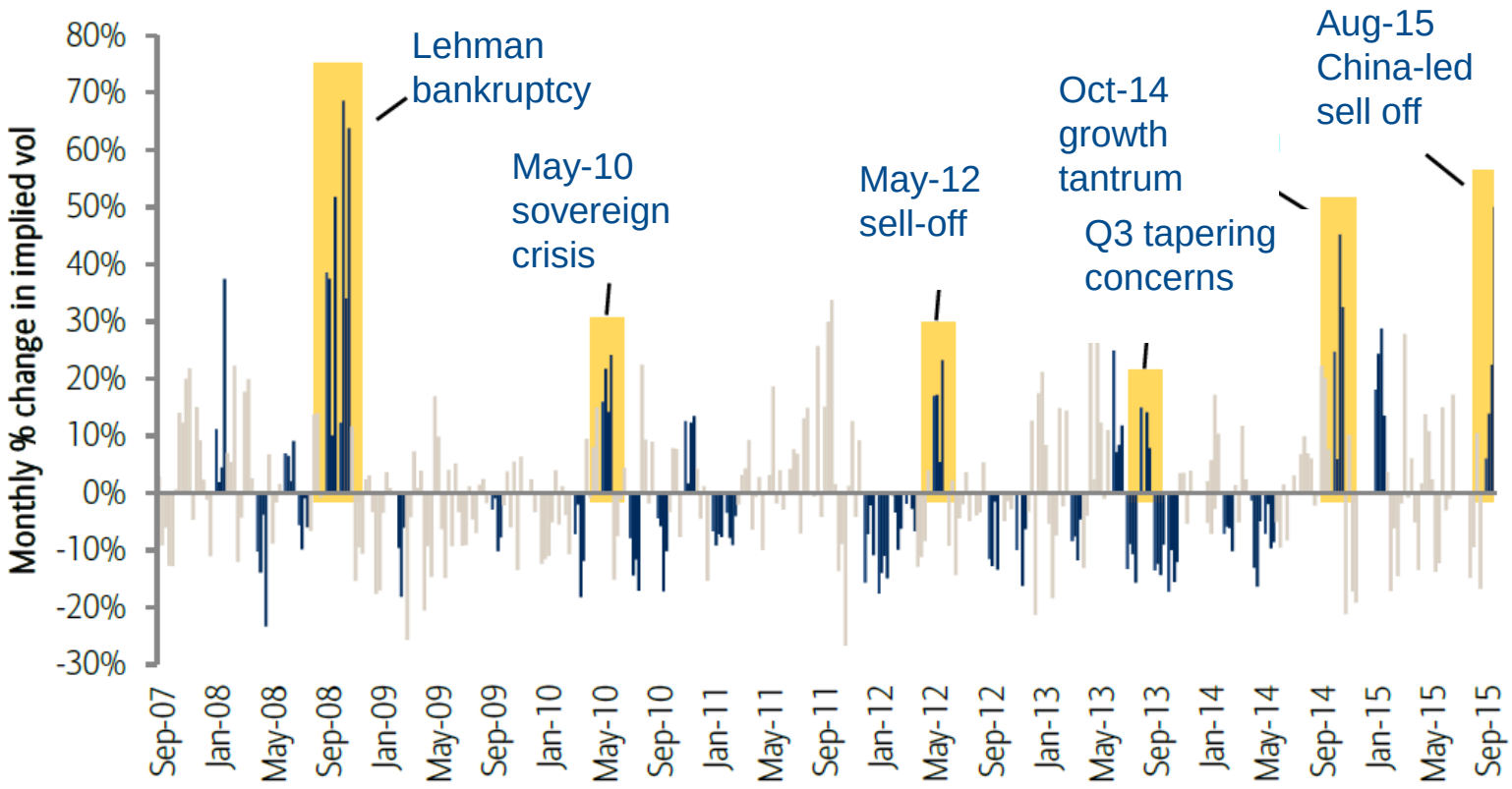
An investor who buys in the “extreme bearish” zone has tended to make out-sized profits in the following six to 12 months

Source: (Left) BofAML Global Investment Strategy, EPFR Global, September 2015; (right) Barclays Research, Investors Intelligence, as at September 2015

Global market sentiment (2)

As bearishness rises: “contrarian buy” signal nearing?

Month-on-month changes in cross asset volatility, blue bars show when there is high correlation in asset volatility



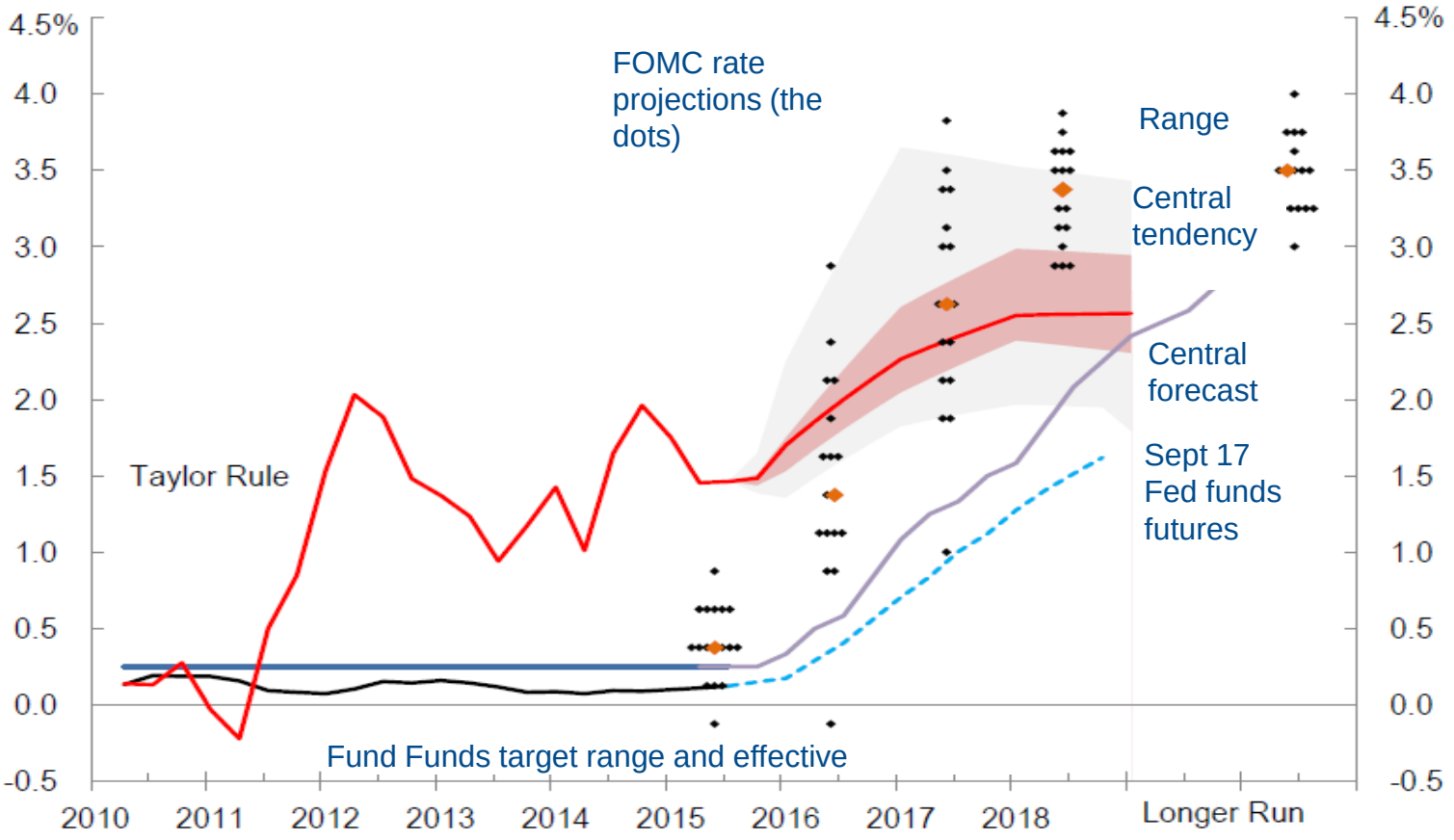
Is it temporary or is there a more serious problem to come?

Source: BofA Merrill Lynch Global Research. Monthly data from 1 September 2007 to 9 September 2015
Monthly % change in three-month ATM implied volatilities on: interest rates (Europe and US), FX (EUR/USD, USD/JPY, GBP/USD), commodities (MLCX Index) and equities (S&P500, ESTX50, FTSE 100, Nikkei 225, HSI).

Fed Fund Rate hikes

When? How fast? How much?

Lower and slower projected 'normalisation' path and lower FOMC dots



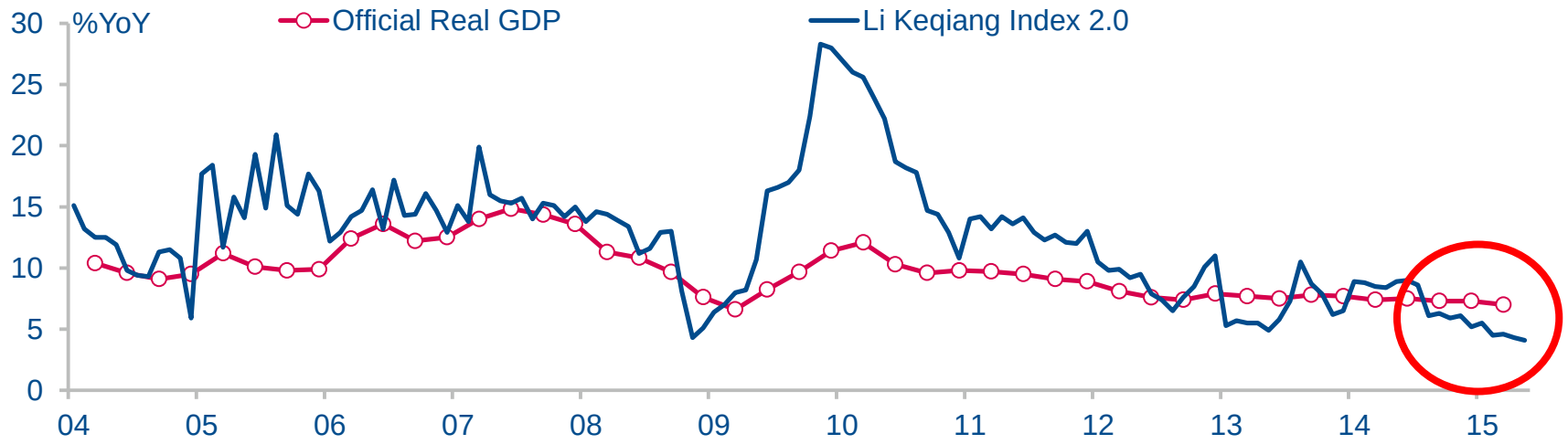
One of the most important 'guessing games'

Source: Federal Reserve and Citi Research, as at September 2015

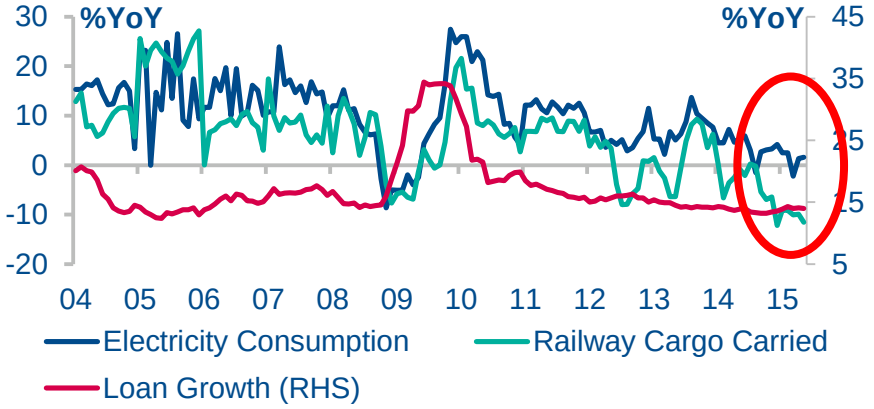
Chinese economy

"Li Keqiang" Index: very weak manufacturing sector

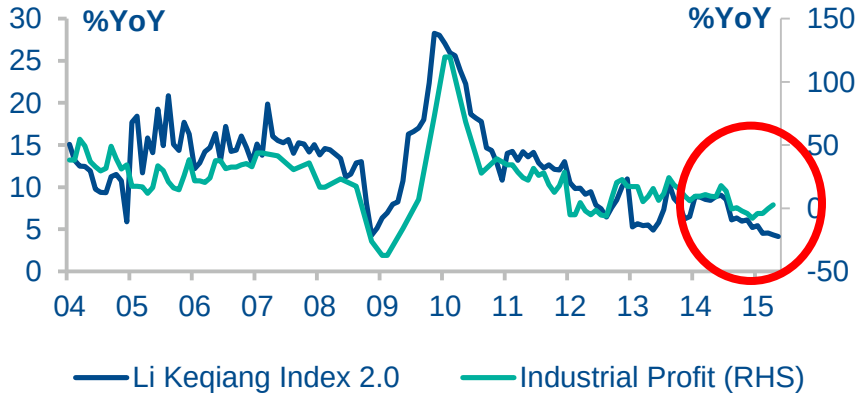
The LKQ* Economic Index versus Official GDP Growth Rate



Components of the LKQ* Economic Index



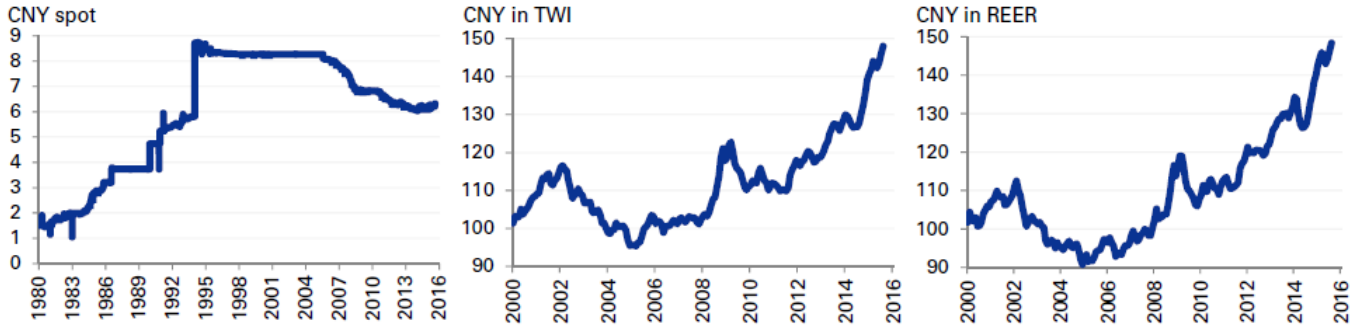
LKQ* Economic Index versus Industrial Profit Growth



*Includes a) electricity power consumption; b) railway cargo carried; and c) loan growth data
Source: Citi, as at June 2015

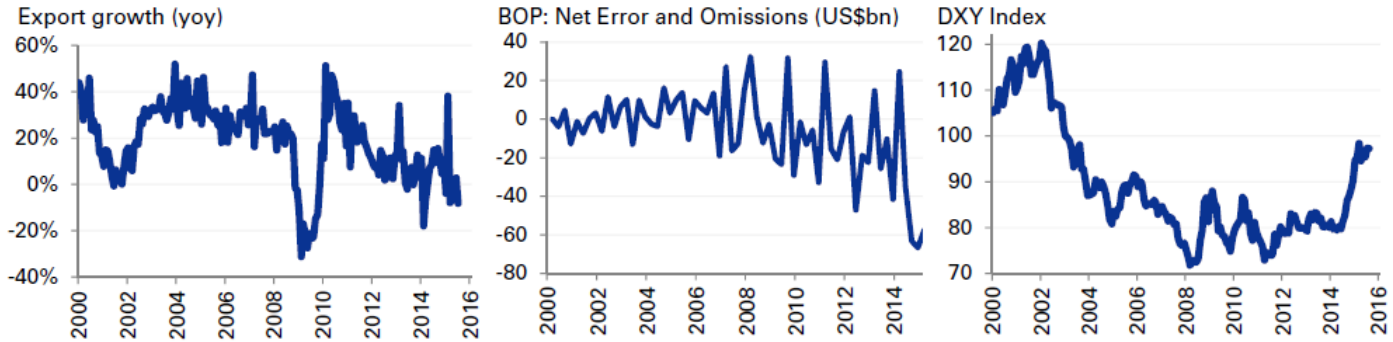
The RMB devaluation
How much further?

Exhibit 1: Looking at the RMB exchange rates from different perspectives



Source: Bloomberg, Haver, Goldman Sachs Global Investment Research.

Exhibit 2: The commonly-cited reasons to argue for/expect the RMB to depreciate



Note: BOP: Net Error and Omissions can serve as one of the measures for hot money outflows. See EM Macro Daily: Interpreting China's FX flows and position, Feb 10, 2015

Source: CEIC, PBOC, SAFE, Bloomberg.

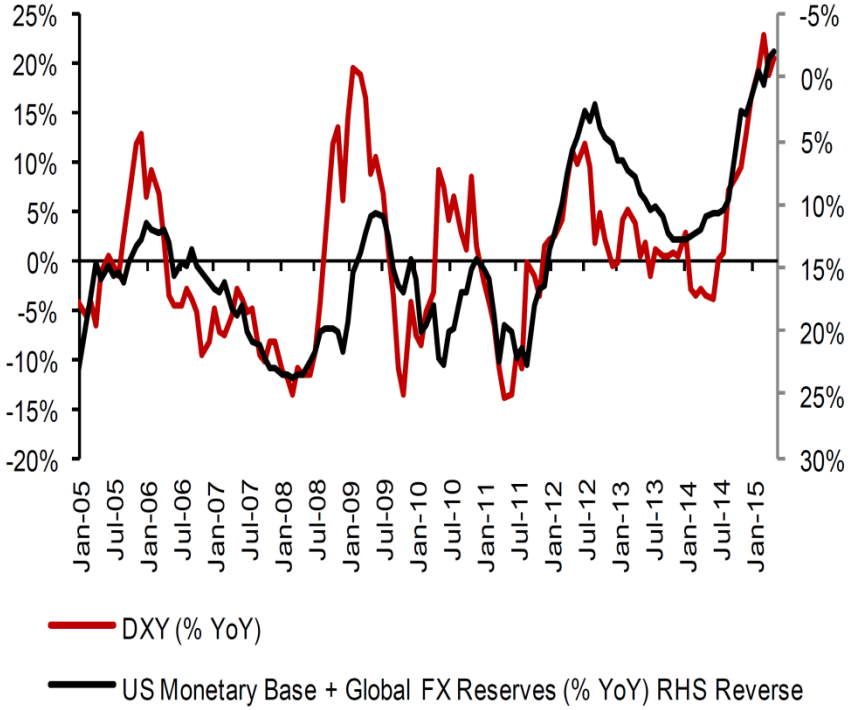
Will China use this tool as "forcefully" as the Fed, BoE, ECB and BoJ?
We think "not likely": a 30% devaluation could cause a debt crisis in Asia/ emerging markets

Source: GS Global Macro Research, as at August 2015

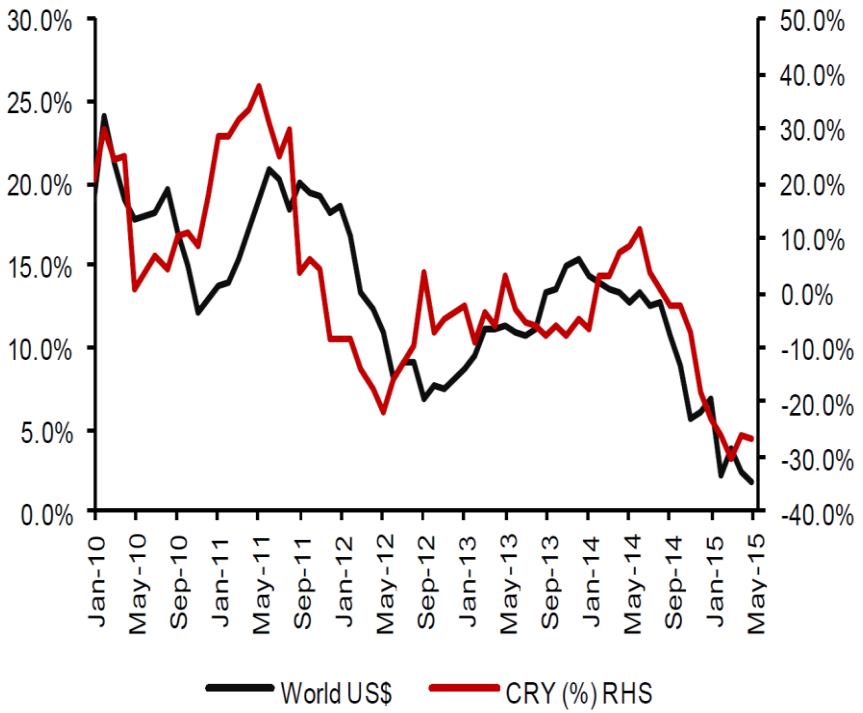
Shortage of USD in the world

If this trend were to continue, then …

Global USD supply versus DXY Index



World USD versus CRY Commodity Index



… USD is likely to strengthen versus emerging markets currencies, and commodity prices as well?

Source: Bloomberg; Macquarie Research, as at July 2015

Global economic outlook

- How will tighter monetary policy impact the US economy and emerging markets currencies?
- Is China already in a recession?

Global economic growth in 2015/16

Is the consensus still too optimistic?

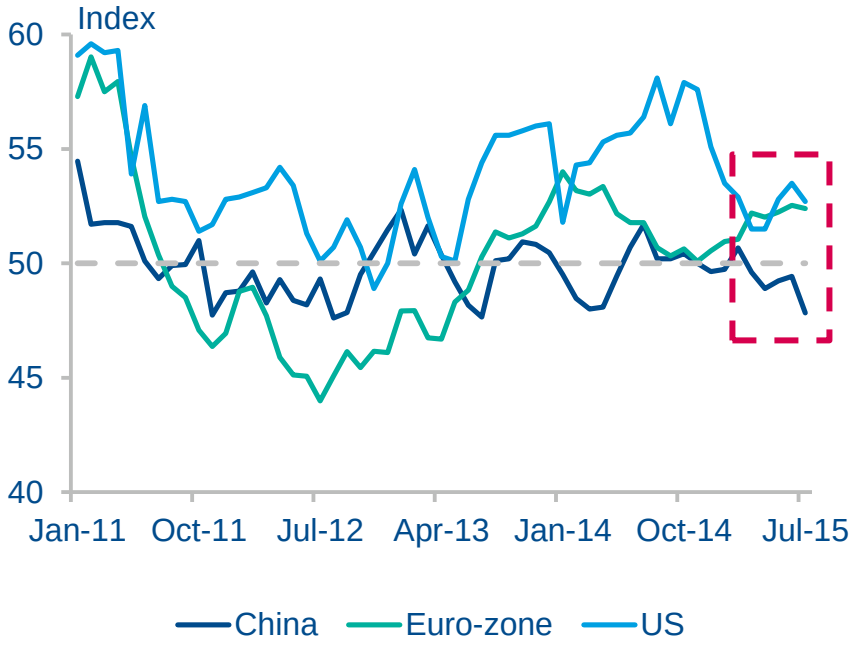
	GDP Growth (%)					
	2011	2012	2013	2014E	2015F	2016F
World	**3.4**	**2.6**	**2.5**	**2.7**	**2.5**	**2.9**
US	1.6	2.3	1.5	2.4	**2.5 (L-T equilibrium)**	**2.5 (L-T equilibrium)**
Eurozone	1.6	-0.6	-0.2	0.9	**1.6**	**2.1 (too high?)**
Japan	-0.4	1.5	1.6	-0.1	**0.6**	**1.0 (too high?)**
China	9.5	7.7	7.7	7.3	**6.9 (too high?)**	**6.8 (too high?)**
Asia ex Japan	7.7	6.3	6.6	6.4	**5.9 (too high?)**	**5.9 (too high?)**
Global emerging	6.5	4.9	4.9	4.3	**3.4 (too high?)**	**4.1 (too high?)**

Source: JP Morgan, as at September 2015

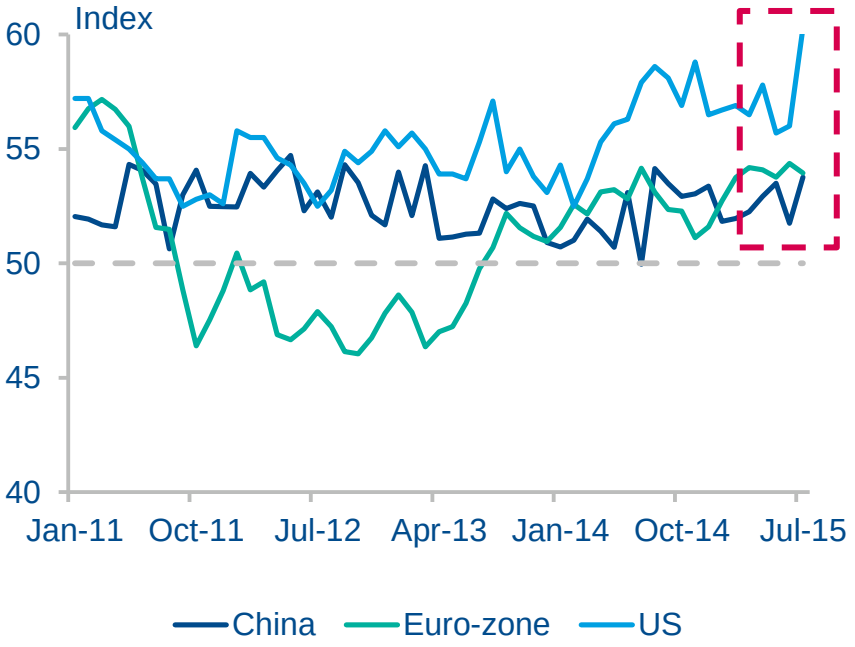
Global economy

Weak manufacturing …. stronger services

Manufacturing Purchasing Managers Index



Services Purchasing Managers Index

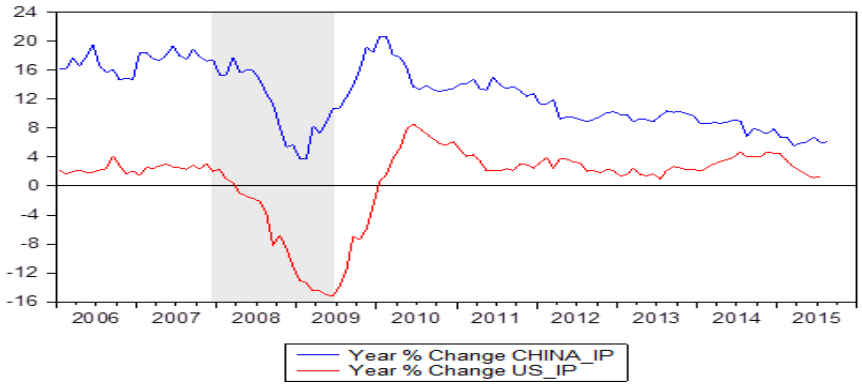


As all economies' services sectors appear to grow solidly (including China), neither China nor the global economy is expected to head into a recession. Recovery in manufacturing would be the icing on the cake

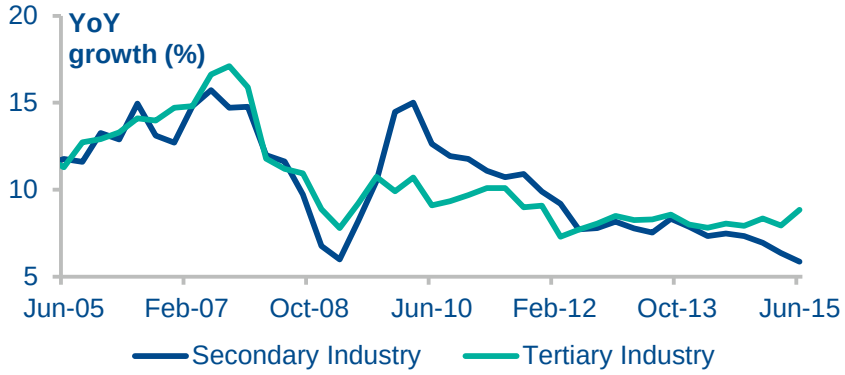
Source: Haver Analytics, Deutsche Bank Research, August 2015

China economy (1)
Proof of solid growth

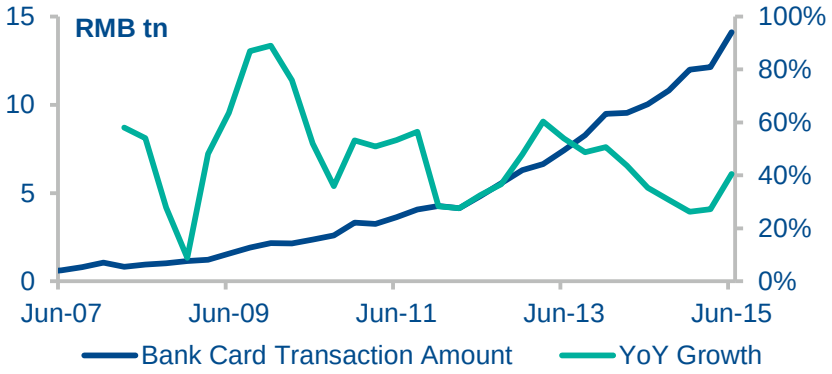
US versus China IP: slowing, but not collapsing



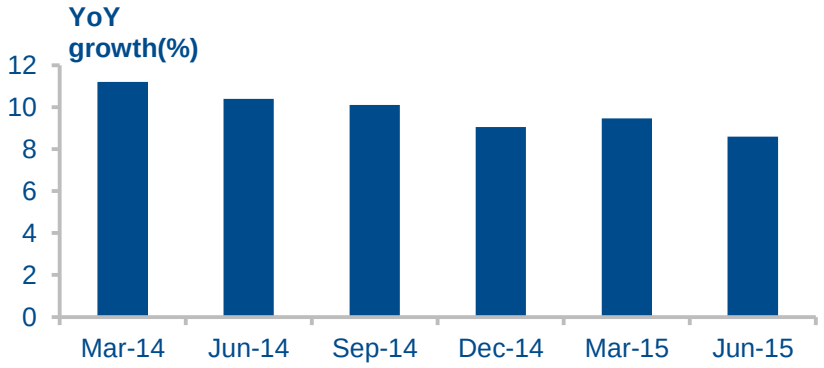
Solid 'secondary' industry (services) growth



China bank card transactions: healthy growth



China disposable income: still growing

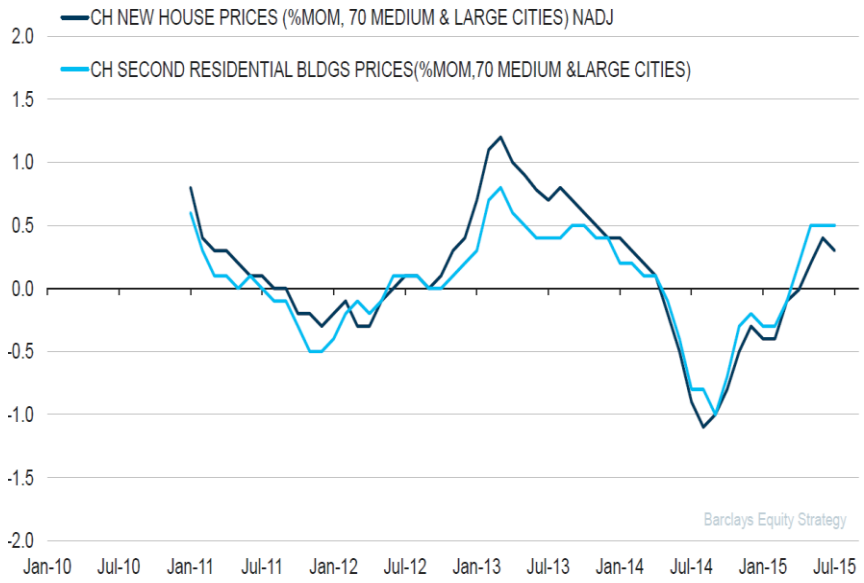


China's services sector appears alive and well

Source: Morgan Stanley, as at September 2015

China economy (2)
Proof of solid growth

Both new and second hand residential prices are increasing again



Retail sales (ex-petrol) and "Global Blue spend" data still strong



Healthy recovery in housing and retail sales

Source: Barclays Research, DataStream, MSCI, as at September 2015

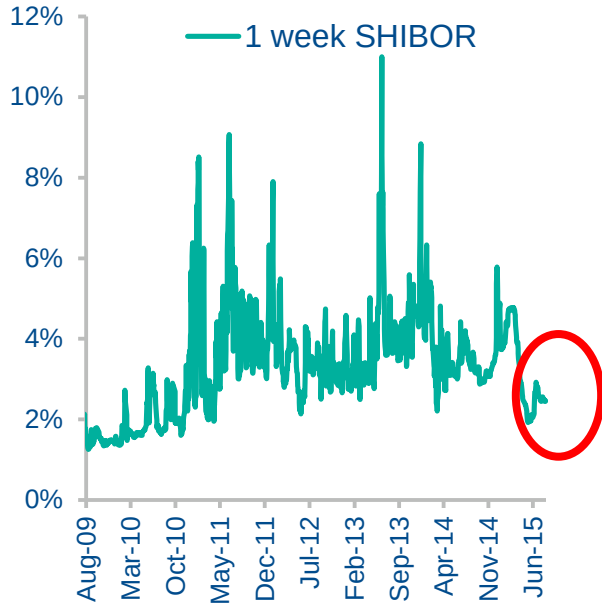
China interest rates

High real rates, high SHIBOR rate, high RRR ratio

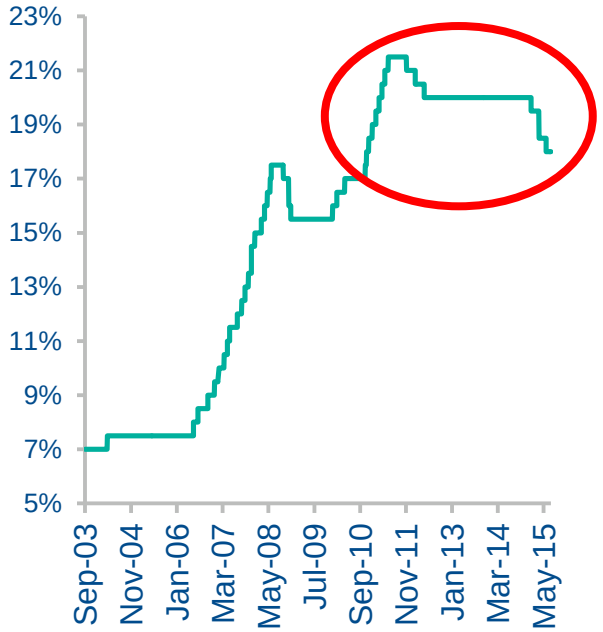
Real 1-year benchmark lending rate (% p.a.)



China inter-bank interest rate has been rising (% p.a.)



China reserve requirement ratio (% of total banking assets) expected to be cut



We expect more cuts, which would help to boost growth

Source: Bloomberg, Morgan Stanley, Barings, as at August 2015

US Treasuries
Dear or cheap?

US 10-year government bond yield



Trading at 2.1% p.a., the US 10-year bond yield has been gradually 'normalised'

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

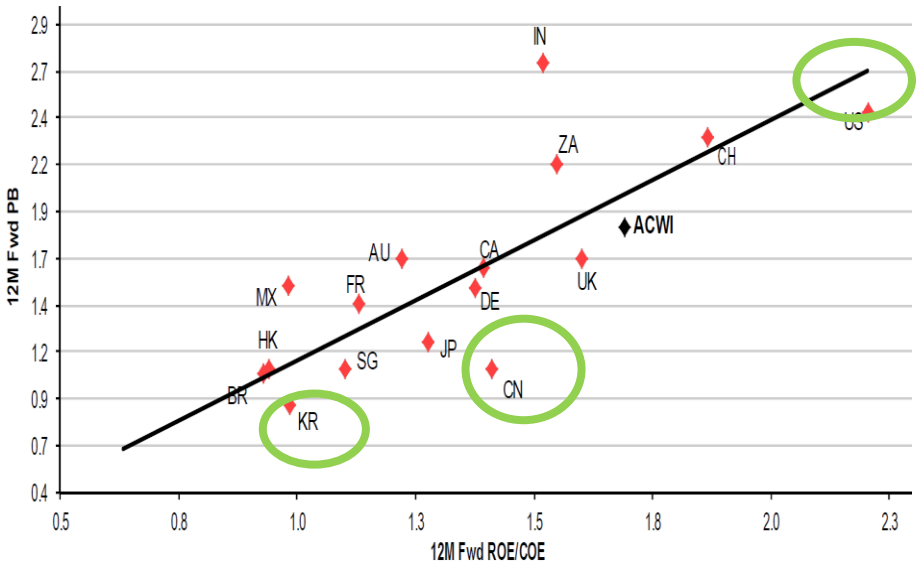
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Global equity markets

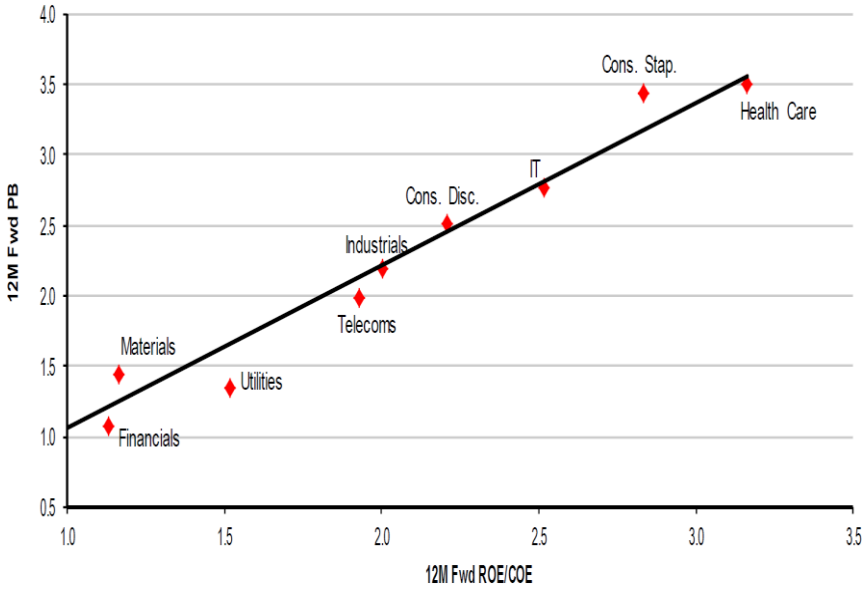
- Is the August “waterfall decline” a sign of things to come?
- Will the cheap Chinese/ Asian/ emerging markets valuations attract investors?

Global equity markets
Any mis-pricing?

Country PB versus ROE/ COE



Sector PB versus ROE/ COE



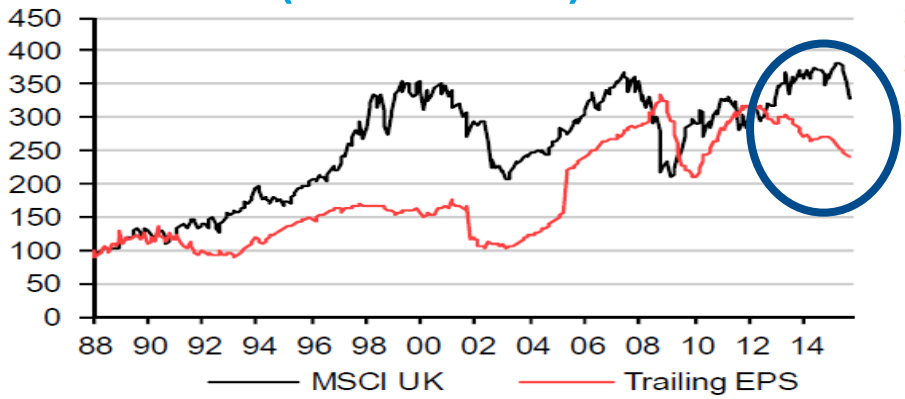
Within sectors, still almost perfectly priced.
Within countries, China, Korea and even the US appear cheap

Source: MSCI, I/B/E/S, Thomson Reuters Datastream, HSBC, as at September 2015

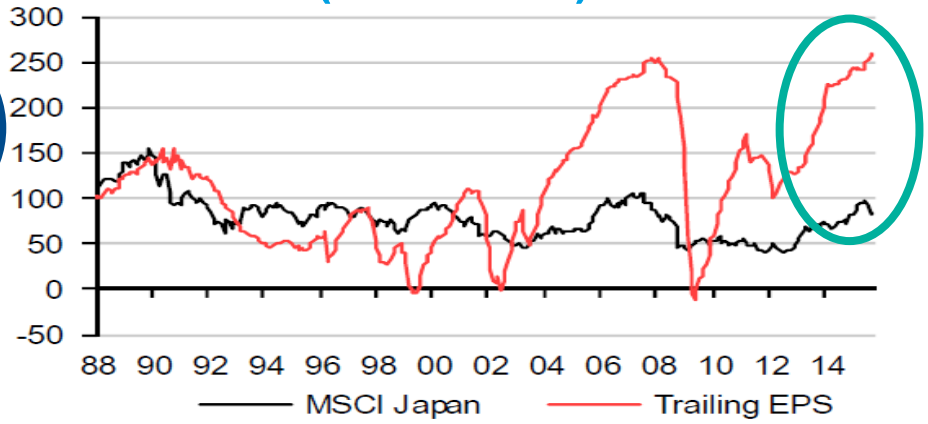
Share price performance versus EPS growth

QE-fuelled … or not?

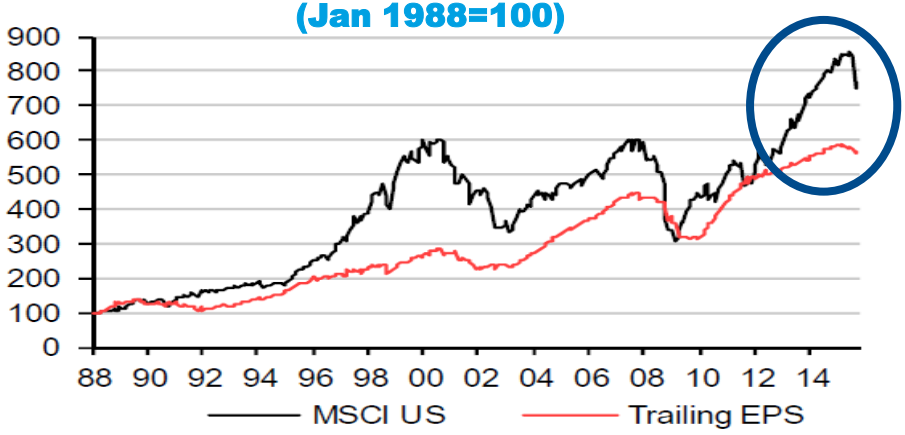
UK price and EPS index (Jan 1988 = 100)



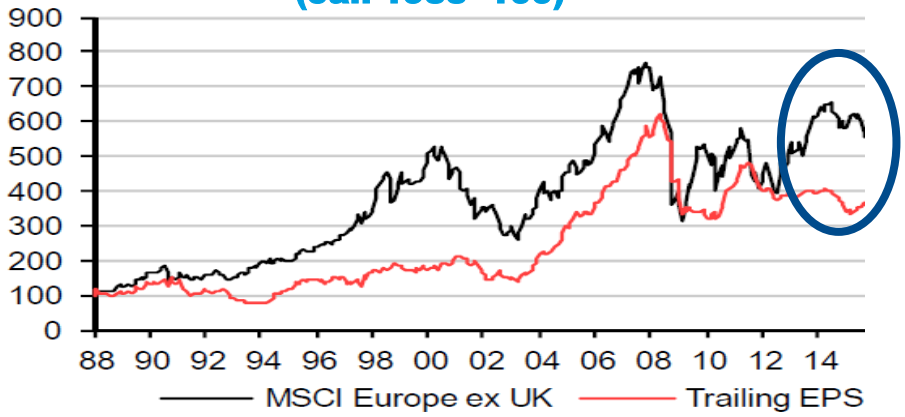
Japan price and EPS index (Jan 1988=100)



US price and EPS index (Jan 1988=100)



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



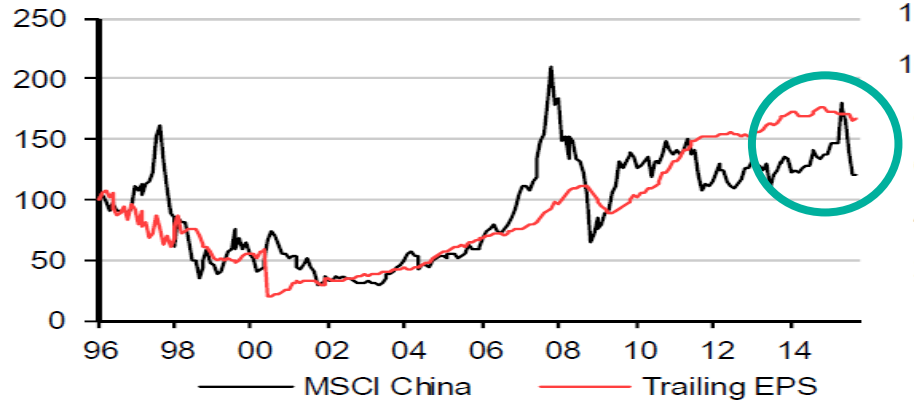
Have US and European markets, fuelled by QE, priced in too much hope, and the reverse in Japan (and emerging markets/ Asia)?

Source: MSCI, IBES, Thomson Reuters Datastream, HSBC, as at September 2015

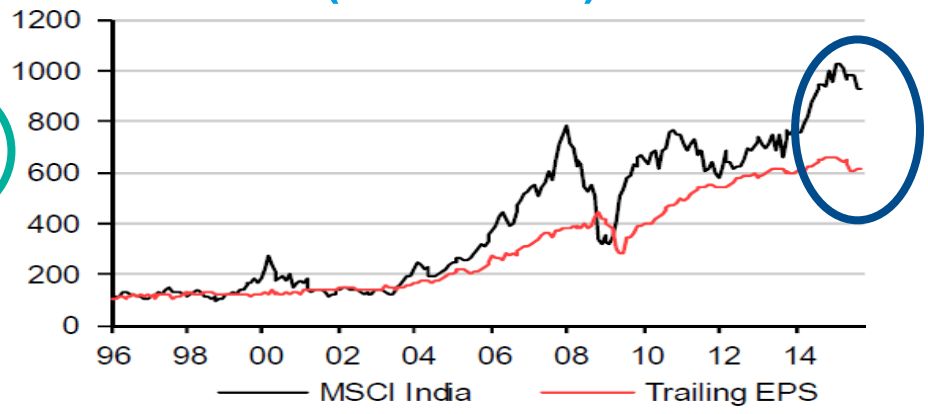
Share price performance versus EPS growth

Which market is undervalued in Asia?

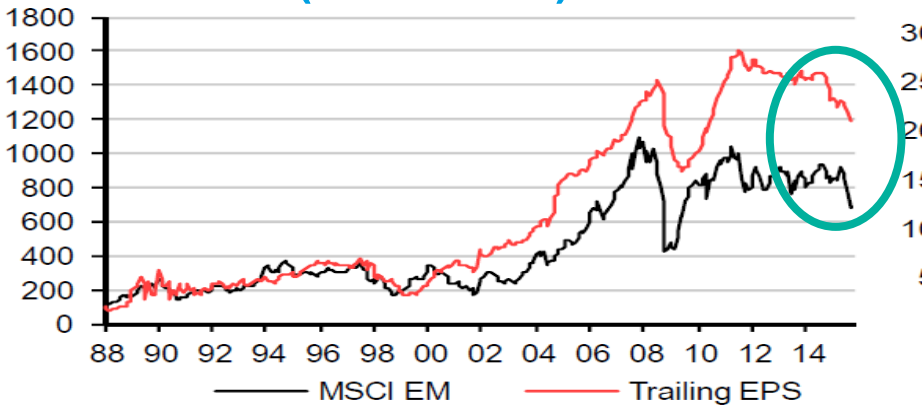
China price and EPS index (Jan 1996 = 100)



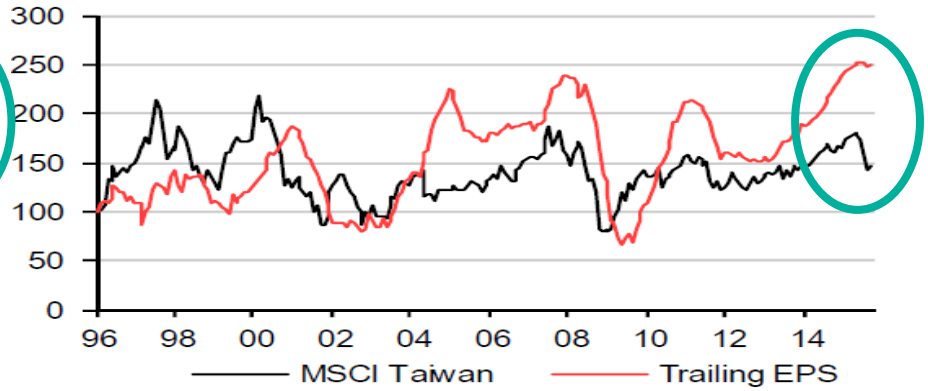
India price and EPS index (Jan 1996=100)



EM price and EPS index (Jan 1988=100)



Taiwan price and EPS index (Jan 1996=100)



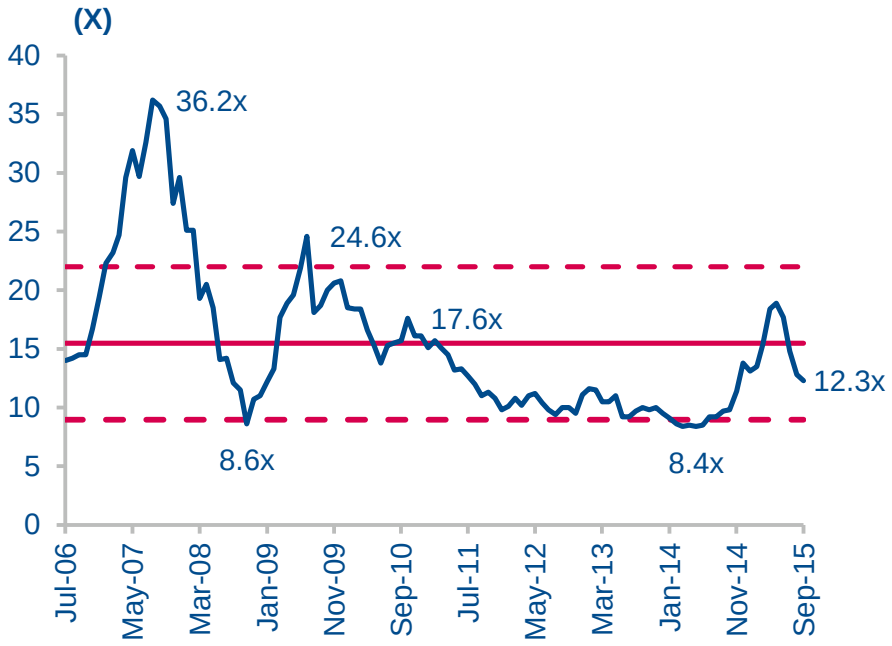
China, Taiwan and emerging markets appear under-valued, whereas India appears overvalued

Source: MSCI, IBES, Thomson Reuters Datastream, HSBC, as at September 2015

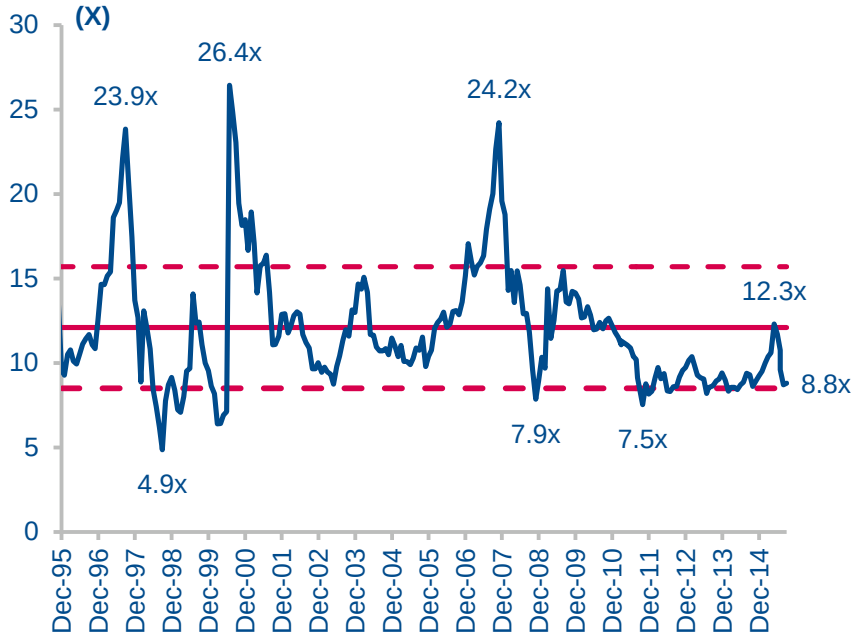
China equity markets

From cheap to fair, now back to cheap valuation again

Valuation of MSCI China A
Forward P/E for MSCI China A



Valuation of MSCI China
Forward P/E for MSCI China



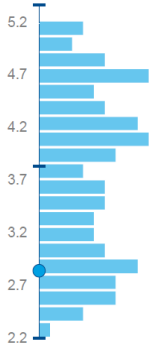
Cheap valuations are acknowledged by investors.
What we need is more visible positive growth drivers

Source: Goldman Sachs, as at September 2015

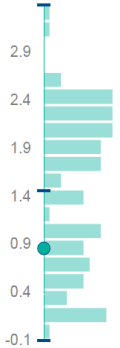
Barings' cross asset valuation analysis

US equity market valuation

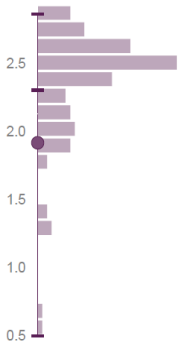
Government bonds



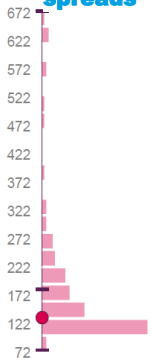
Inflation-linked bonds



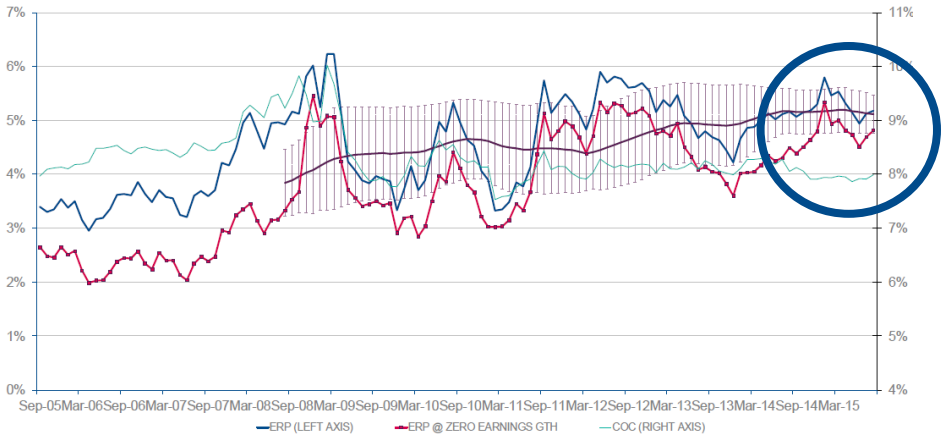
Breakeven inflation rates



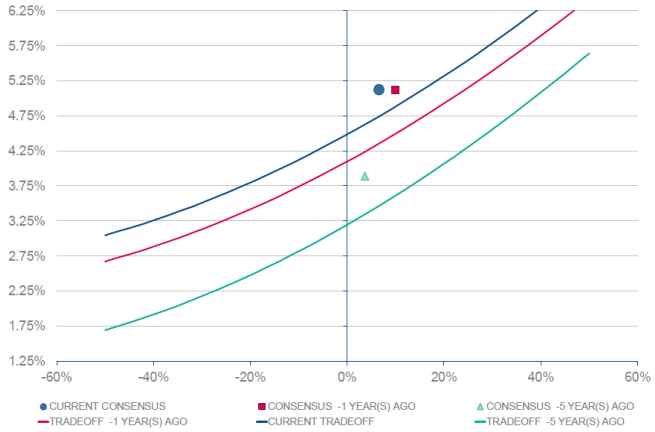
Credit spreads



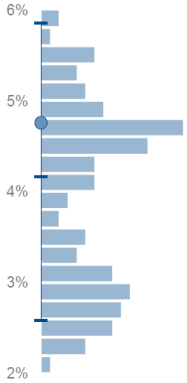
Historic implied equity risk premium of US equities



Implied ERP/ EPS growth trade-off curves (now versus 1 and 5 years ago)



Equities



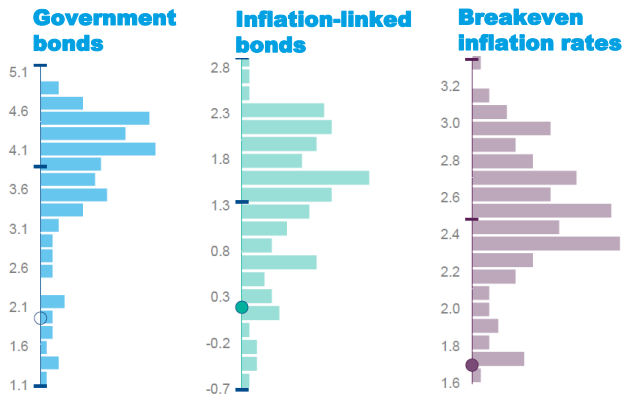
Neutral at present ...

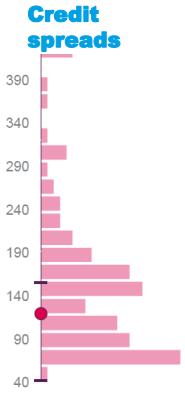
Useful contrarian indicators at extreme inflexion points

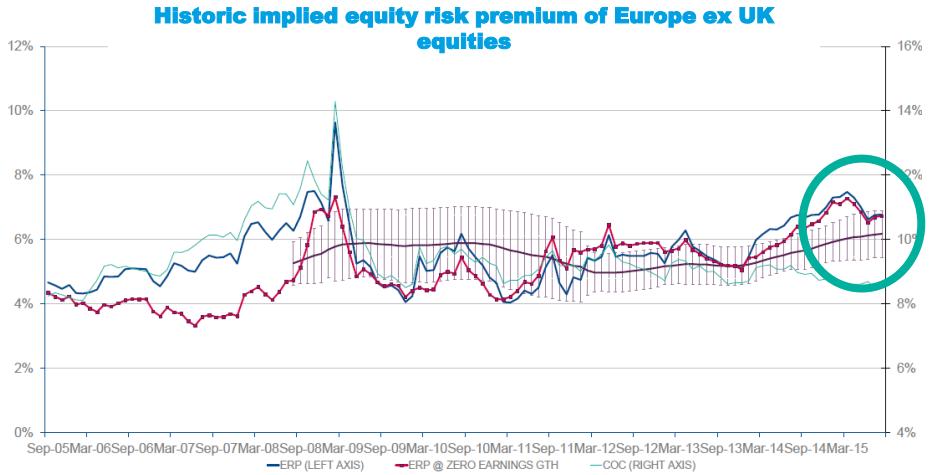
Source: Barings, as at September 2015

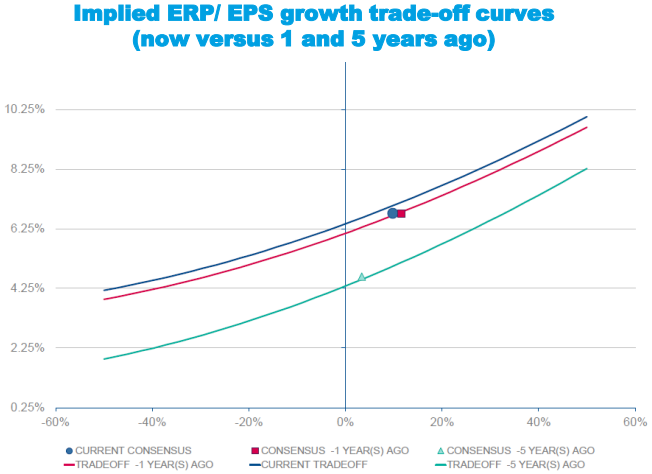
Barings' cross asset valuation analysis

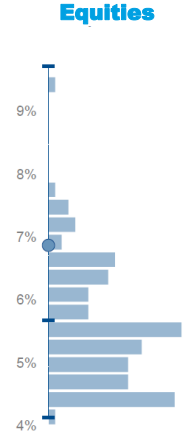
Europe (ex UK) equity market valuation











Very attractively valued versus European bonds

Source: Barings, as at September 2015

Global and emerging/ Asian equity markets

Earnings growth forecasts and valuations

	P/E (x)		Div. Yield (%)	P/BV (x)	Earnings growth (%)				ROE (%)
Country	Current trailing	12 months forward	Current trailing	Current trailing	2013	2014	2015E	2016E	2016E
Global	15.4	14.3	2.5	2.1	8.1	3.9	1.6	10.6	14.1
USA	17.8	16.5	2.0	2.6	8.4	5.4	1.0	10.9	15.7
Europe	15.2	14.1	3.3	1.8	(5.4)	1.4	1.8	10.1	12.9
Emerging Markets	11.4	10.5	3.1	1.3	4.0	0.0	1.4	12.3	11.9
India	19.6	16.3	1.6	3.0	7.5	4.5	13.9	22.2	17.8
China	9.3	8.5	3.4	1.2	11.5	4.0	1.9	12.1	13.8

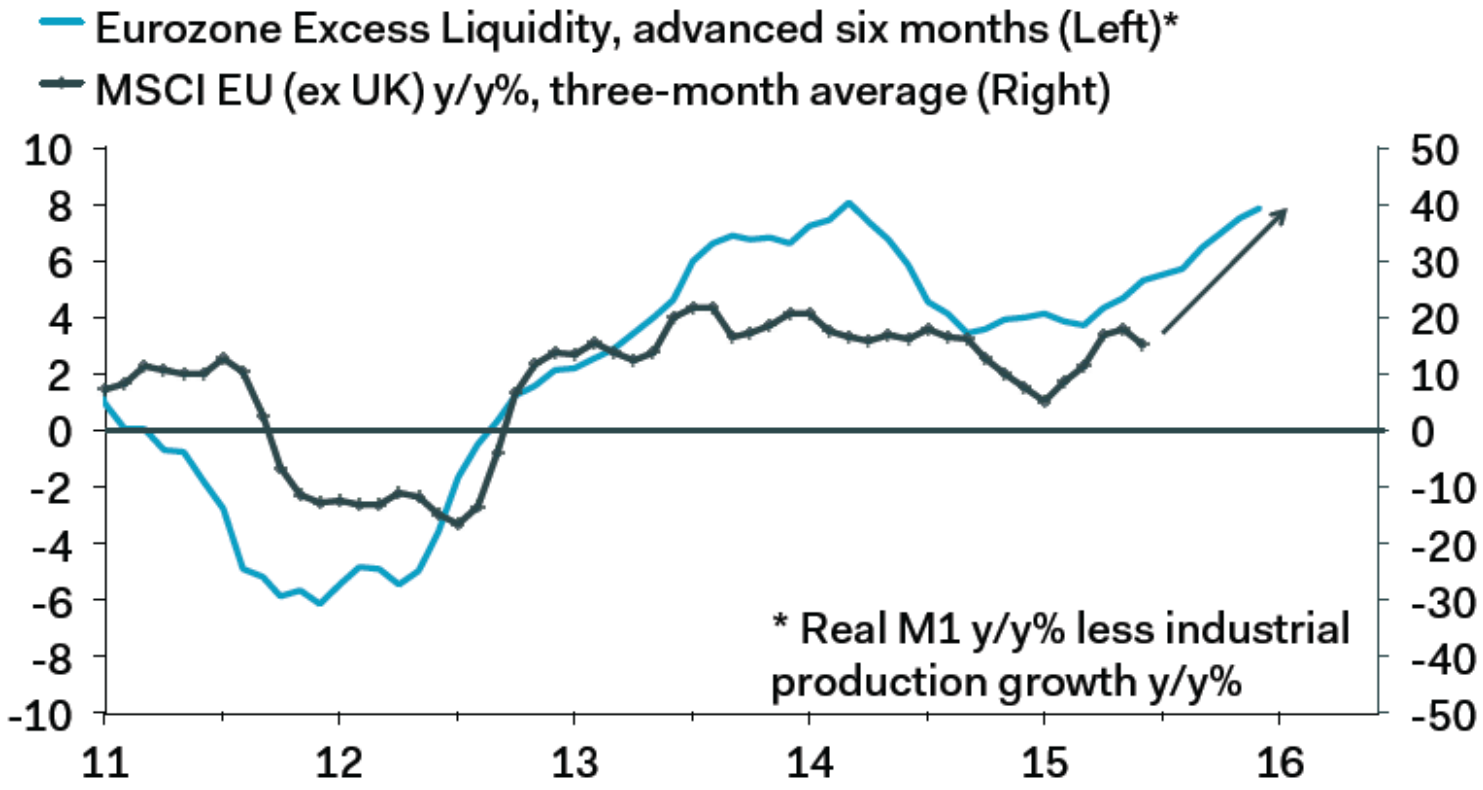
As most of the reduction in equity risk premia in developed markets has occurred, EPS revisions and delivery will be their key driver.

For Asia/ emerging markets, it has more to do with their equity risk premium: will it fall now that China has started to ease?

Source: I/B/E/S, MSCI, J.P. Morgan estimates, as at September 2015

European equity market
Liquidity "tailwinds"

Eurozone excess liquidity versus MSCI EU (ex UK)

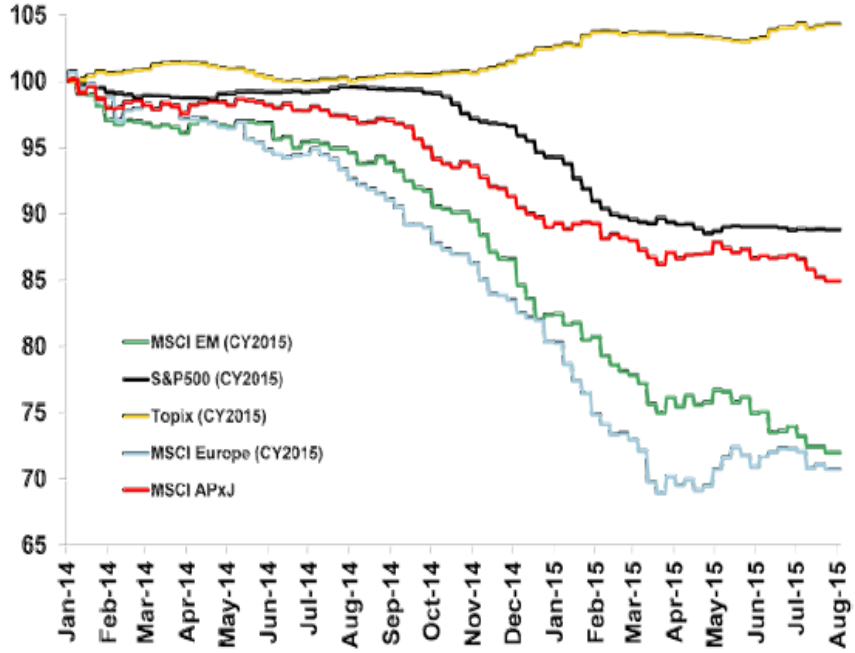


The ECB's commitment to implement its QE program until Sept 2016 is an important driver of European equities

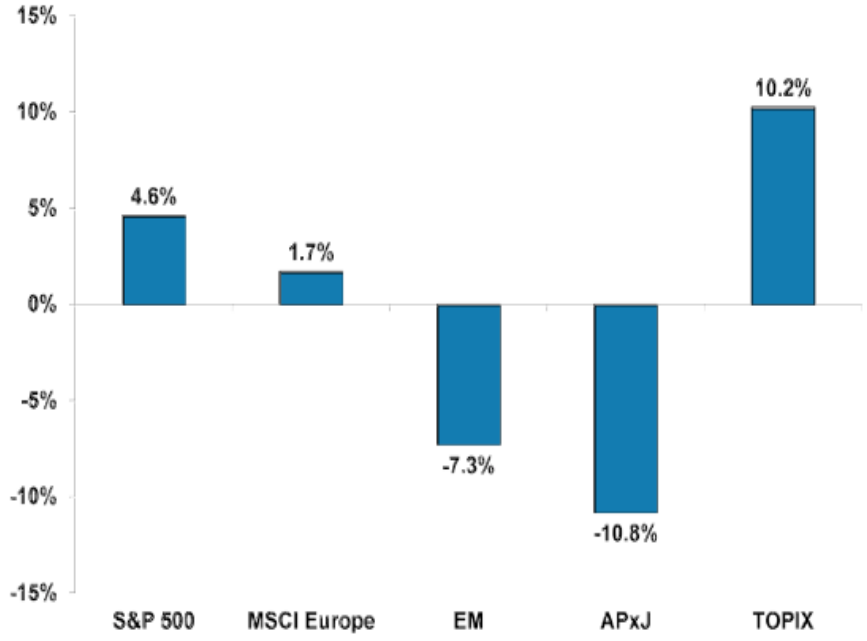
Source: Panthen Macroeconomics, as at August 2015

Japanese equity market
Japanese corporates delivered

2015 consensus EPS by region
Japan only major market where 2015 EPS is revised upward by bottom-up consensus



Topix quarterly (Apr-Jun) earnings
Surprise in comparison to other major markets



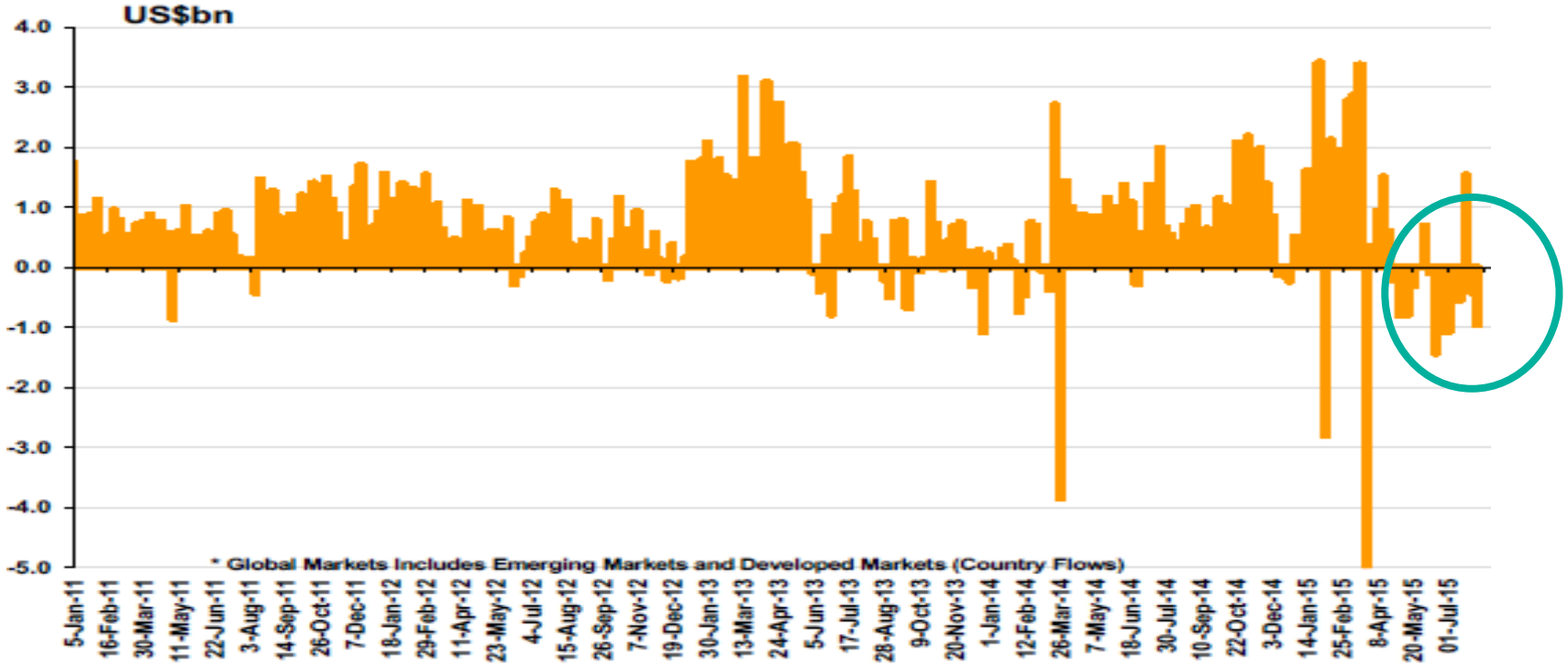
Japanese corporates led, while Asia and emerging markets disappointed

Source: MSCI, IBES, RIMES, Morgan Stanley Research, as of August 3, 2015

Source: MSCI, Bloomberg, IBES, RIMES, Morgan Stanley Research, August 2015. Percentage of mcap reported – 36% for EM, 27% for APxJ, 41% for Europe, 79% for US and 67% for TOPIX

High dividend equities
Out of favour for how much longer?

Global dividend equity funds' flows
Outflows over the past few months



The fear of the Fed's tightening its monetary policy has caused investors to take profit in high-yielding income funds. Will this continue?

Source: EPFR Global, Fund Flows Data Base, Morgan Stanley Research, as of 5 August 2015

Barings' global asset allocation
Current tactical directions

	Aggressively underweight [5]	Underweight [4]	Neutral [3]	Overweight [2]	Aggressively overweight [1]
Overall		Credit (Investment grade)	Credit (High yield) Government bonds Cash/ equity Index-linked bonds		Property
Equities		UK / Emerging Asia Singapore/ Canada/ Australia Emerging Latin America	Emerging Europe US MSCI Hong Kong	Japan →	Europe [2]
Sectors		Energy Utilities Materials	Industrials/ telco Healthcare Information technology Consumer staples	Consumer discretionary Financials [1] ←	
Bonds			Japan/ Emerging markets Local US/ UK Germany/ Italy		
Currencies			JPY Gold/ EUR	GBP	

Previous score in brackets if score changed – [ ] means upgrade, and [ ] means downgrade
Source: Baring Asset Management, September 2015

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