A stabilisation in projected world growth rates

Summary

The markets appear to have stabilised after an extremely volatile end to 2018. In line with a strong rally that has lifted the MSCI World 11.7% this year, the VIX index of volatility has fallen back to almost normal levels. The threat of recession has eased, at least for the time being, thanks to the Federal Reserve's return to an accommodating monetary policy and hopes of a settlement in the US-China trade war. The S&P 500's 20% correction in the final three months of 2018 was a severe setback that we see on average only once every six years: corrections of this magnitude have signalled recession slightly more than half the time. The market effectively forced the Fed to adjust its policy and the US yield curve now looks a little odd. It is slightly inverted out to the 5-year maturity and positively sloped beyond that point. That implies unchanged Fed rates for some years, but that could all change in the event of rising inflation. US economic growth was a robust 2.9% last year, including a 6% jump in investment. The trade deficit reduced growth, but the current balance is now only marginally negative at $124 billion, even with apparently elusive profits at GAFA and certain other firms.

Forecasts for world GDP growth this year appear to be stabilising at a very respectable 3.1%, after 3.3% in 2018. Persistently sluggish activity in the euro zone is more than offset by the resilience of the USA and several emerging economies. Germany is struggling, while France is posting slightly better growth following the budgetary sop thrown at the so-called yellow jacket movement. The American economy is the engine of international activity and is reporting a whole array of positive indicators, from rebounding consumer confidence to the services PMI and a rising participation rate. Credit markets have recovered a measure of calm and spreads on the riskiest borrowers have contracted. The prospects of a no-deal Brexit have faded and the UK could yet be tied to the EU for some years because of the Northern Irish issue.

This backdrop has helped analysts to stabilise their earnings estimates, and the up/down revisions ratio has started to pick up again. The consensus forecast for American EPS growth in 2019 is 3.3%, and 4.3% excluding energy. Our own top-down hypothesis is an unchanged 2.1%. The consensus figure for 2020 is 11.6%; we are retaining 9%. The 12-month forward PER is 16.5, and comparisons with the 2000s show that the gains in the PER can be attributed entirely to a fall in the 30-year rate from 5% to 3%. Our S&P 500 valuation gives us a year-end objective of 2,699 points with a 30-year rate at 3.09% and a CAGR of 3.4%. The market's current level implies an 8-year CAGR of 4.5%, which could be justified by an inflation rate of 2.2% and 2.3% GDP growth.

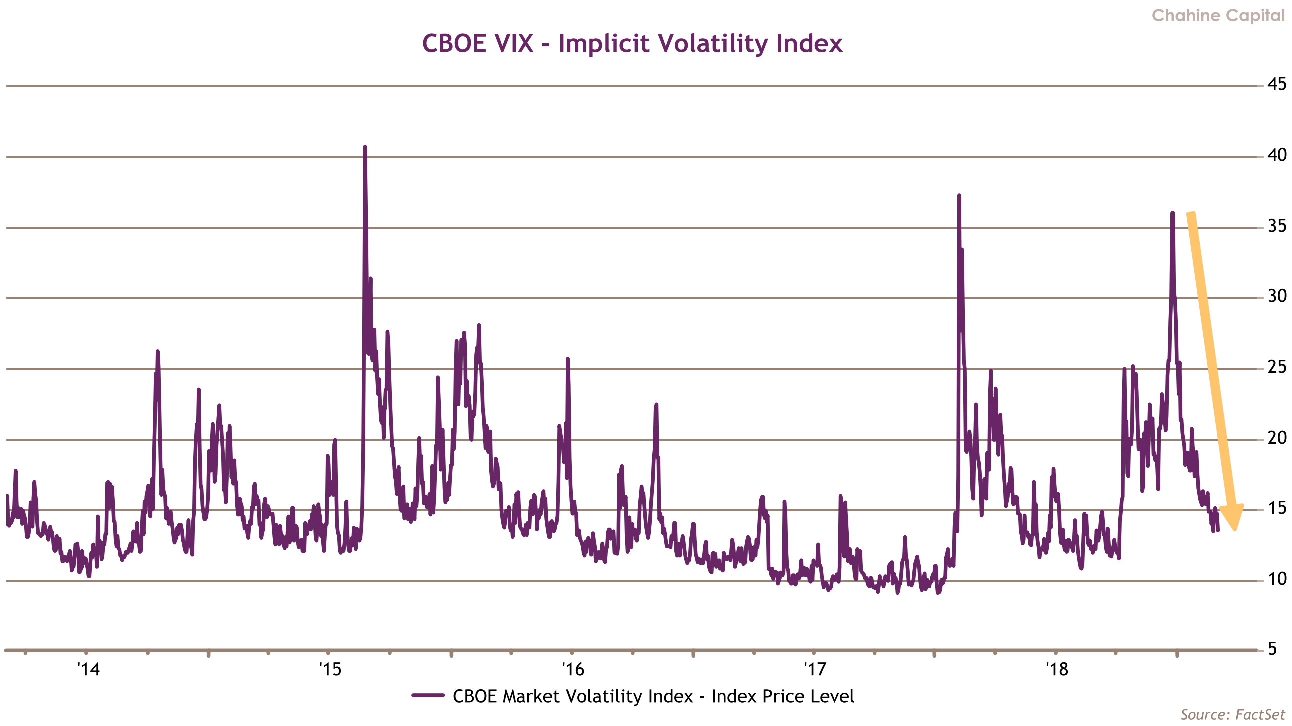
The catch is that US profit margins are at their highs and massive asset depreciation slashed GAAP earnings dramatically in Q4. Non-GAAP earnings suffered far less. Given that there is every likelihood of a slowdown in the coming eight years that could dent profits, our more conservative CAGR is more comfortable. Being right two years down the line is not so comfortable, however! This is why asset allocation is not a matter of black or white but of playing at the margins. We happen to be moderately underinvested, but cash-rich investors would be advised to go with sound equity management. In Europe, our Digital funds have made good earlier losses. If another correction materialises, investors should look at the situation at the time and take decisions with our valuations in mind.

Jacques Chahine

Calm returns to the markets

The markets appear to have stabilised after an extremely volatile end to 2018. The VIX index of volatility, which measures precisely that, has fallen back to almost normal levels. This has been associated with a strong rally in share prices, with the S&P 500 rising 12.3% since the start of the year to wipe out the 4.4% total return loss it suffered in 2018. World equities have followed Wall Street, lifting the MSCI World index 11.7% in dollars. The threat of recession that triggered the severe correction in Q4 has faded, at least for the time being. The Fed's return to a more accommodating policy – effectively ordered by the market – and a lull in the Chinese trade war have saved the day. Donald Trump's obsession with his re-election has forced him to ease up on his trade policy, as it is inflicting serious damage on IT stocks. While Apple has been the most obvious victim of Chinese reprisals, most groups dealing in hardware and software have been affected.

A rebounding market has helped dampen volatility



A diminishing threat of recession

The correction wiped 19.8% off the S&P 500. Only 11 corrections of that magnitude or more have been recorded since 1956, meaning that they occur on average once every six years. Of those 11 setbacks, seven signalled recession and four turned out to be false alarms. One of the more instructive examples was the so-called flash crash of 1987, which slashed share prices by 33% but without any subsequent recession. That has similarities with the latest episode, especially as the Fed was also hiking its rates at that time and altered course significantly when the crash came. The market was concerned with several other negative signals, such as an inverted yield curve. This is also associated with slower economic growth in the future.

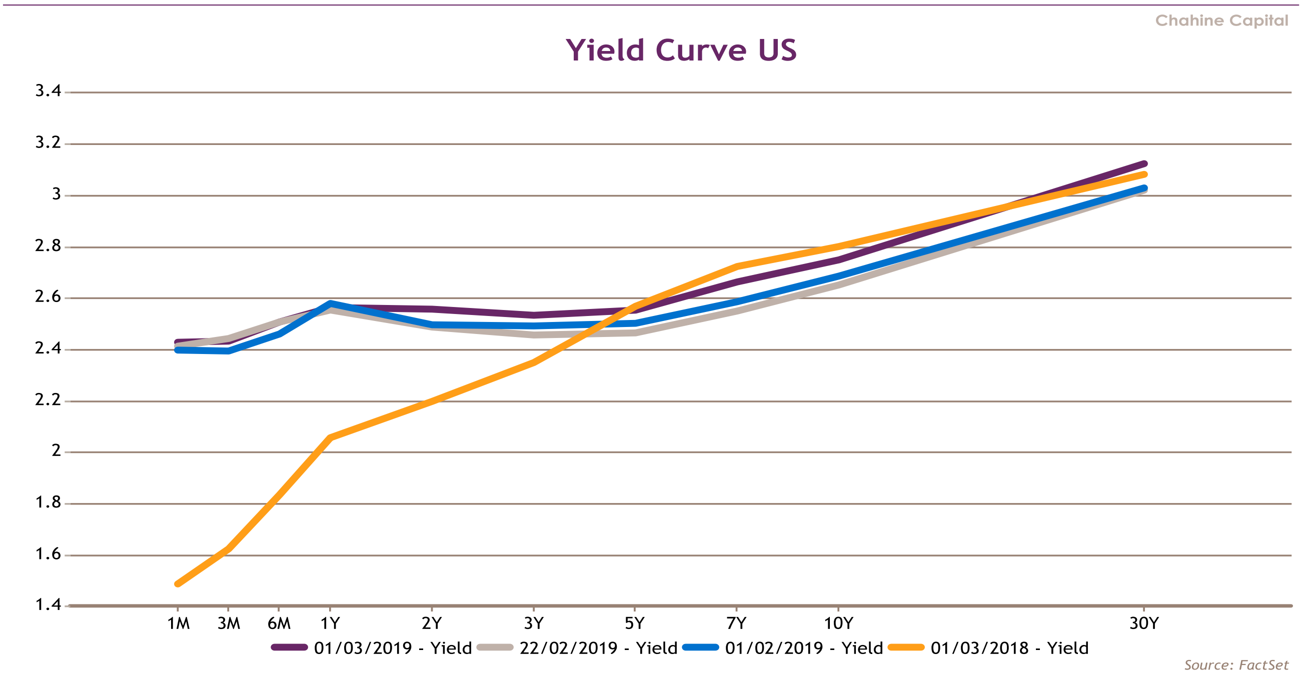
The threat of recession has faded – for now

Drawdown	Date High	Date Low	Date Recovery	Days to recover	Days to bottom	min value	max value	Type
-21.5%	**03/08/1956**	**22/10/1957**	24/09/1958	**337**	445	39.0	49.6	Récession
-28.0%	**12/12/1961**	**26/06/1962**	03/09/1963	**434**	196	52.3	72.6	Correction
-22.2%	**09/02/1966**	**07/10/1966**	04/05/1967	**209**	240	73.2	94.1	Correction
-36.1%	**29/11/1968**	**26/05/1970**	06/03/1972	**650**	543	69.3	108.4	Récession
-48.2%	**11/01/1973**	**03/10/1974**	17/07/1980	**2114**	630	62.3	120.2	Récession
-27.1%	**28/11/1980**	**12/08/1982**	03/11/1982	**83**	622	102.4	140.5	Récession
-33.5%	**25/08/1987**	**04/12/1987**	26/07/1989	**600**	101	223.9	336.8	Correction
-19.9%	**16/07/1990**	**11/10/1990**	13/02/1991	**125**	87	295.5	369.0	Récession
-19.3%	**17/07/1998**	**31/08/1998**	23/11/1998	**84**	45	957.3	1186.8	Correction
-49.2%	**24/03/2000**	**09/10/2002**	30/05/2007	**1694**	929	776.8	1527.5	Récession
-56.8%	**09/10/2007**	**09/03/2009**	28/03/2013	**1480**	517	676.5	1565.2	Récession
-19.8%	**20/09/2018**	**25/12/2018**	--	**--**	96	2351.1	2930.8	???

An unusual yield curve

The US yield curve has changed shape over the past year and now looks rather odd. It is slightly inverted out to the 5-year and positively sloped after that point, suggesting that the market expects no change on Fed rates from their current 2.5% for several years. That means in turn that the Fed will continue to supply the system with easy money and real rates will be barely positive, given inflation of between 2% and 2.2%. Top-quality names can borrow at Libor plus 0.5-1%, i.e. at 3-3.5% over the medium term, which is very positive for investment in an economy that posted a 2.9% rise in GDP last year.

A yield curve that encourages investment



America's vigorous economic growth and investment

The 2018 US growth figures published last week confirm robust private investment, which increased 6% and now accounts for 18% of GDP. Consumption is also vigorous and increased 2.6%. The contribution of foreign trade to growth is a negative 0.2%, but this gives a misleading impression of what is actually happening.

Buoyant investment lifting US activity

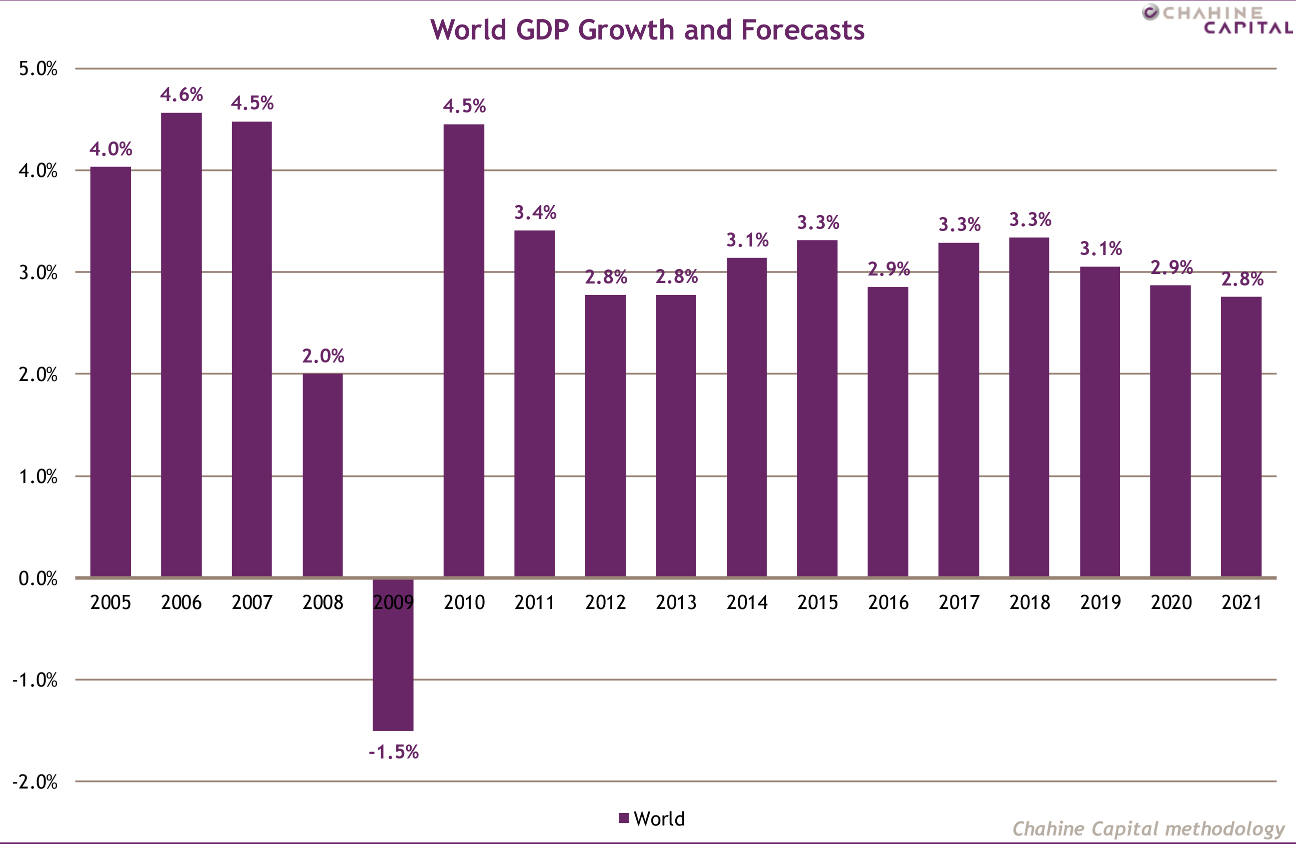
	2 018	2 017	2 016	2 015	2 014
Gross Domestic Product	**2.9**	**2.2**	**1.6**	**2.9**	**2.5**
Personal Consumption Expenditures	2.6	2.5	2.7	3.7	2.9
Government Consumption & Gross Investment	1.5	-0.1	1.4	1.9	-0.9
Net Exports of Goods & Services					
Exports	3.9	3.0	-0.1	0.6	4.3
Imports	4.6	4.6	1.9	5.5	5.1
Gross Private Domestic Investment	6.0	4.8	-1.3	4.8	5.4
Other					
Gross National Product	-	2.3	1.5	2.8	2.5
Disposable Personal Income	2.9	2.6	1.7	4.1	4.0

The American trade deficit that so worries Mr Trump has to be put into context. It amounted to $900 billion last year, but the broader current-account deficit was $124 billion. The latter account includes the balance of profits and capital, which is heavily in surplus. The real position is also complicated by the fact that GAFA and other firms' earnings are proving somewhat elusive at the moment. China is more than capable of putting pressure on these profits, but Europe is still (and unfortunately) divided on the issue.

A stabilisation in world growth forecasts

World growth forecasts for 2019 appear to be stabilising. They are unchanged for two months now at a very respectable 3.1% in 2019, compared with a close-to-definitive 3.3% last year. Vigorous activity in the USA and several emerging economies is offsetting the euro zone's sluggish trajectory. Several eastern EU countries are performing strongly, such as Poland, Hungary and the Baltic States, but Germany was hit hard by the trade war in Q3 and Q4. France actually reported faster growth, notwithstanding the yellow jacket movement, and GDP rose 0.3% in Q4. The Banque de France expects GDP to rise another 0.4% in Q1, thanks partly to President Macron's €10 billion budget giveaway. Italy is still lagging the rest of the EU and will verge on recession this year.

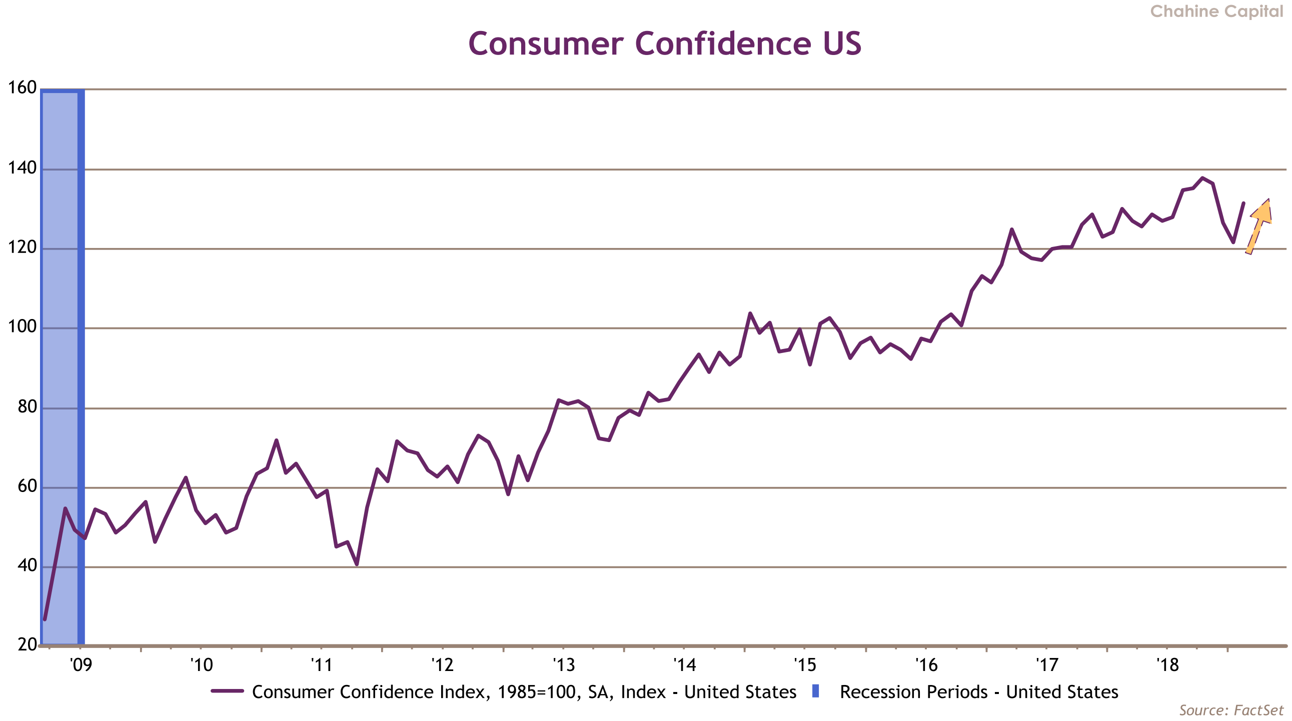
World growth stabilising at a decent level



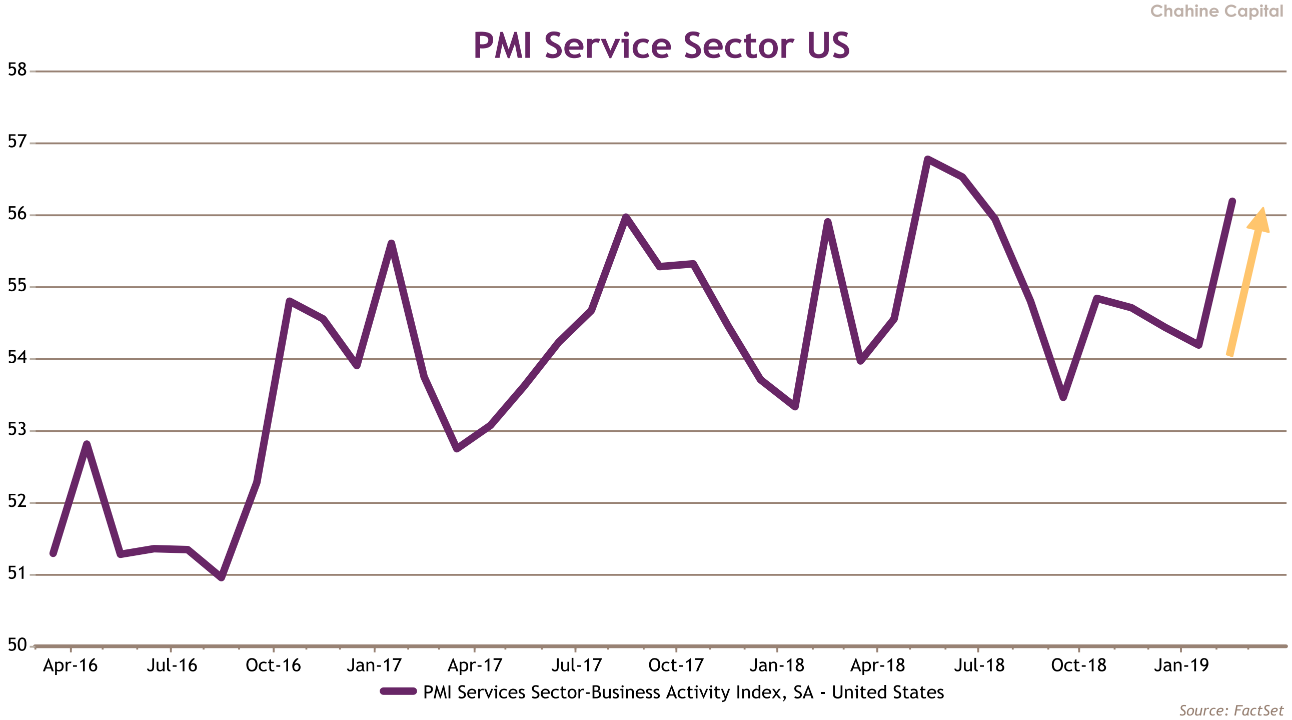
Despite the talk around slower Chinese growth, Asia is still one of the big drivers of international activity. Chinese GDP is set to rise 6.1% in 2019, compared with 6.6% in 2018, highlighting the authorities' desire to press on with serious investment. Growth will remain buoyant in India (7.2%), Indonesia (5.1%), Malaysia (4.6%), Philippines (6.4%) and Vietnam (6.6%). Brazil is renewing with growth but Argentina is still in recession. Mexico presents systemic risk, combining unchecked population growth with an anaemic economy, high inflation and rampant corruption. The Trump wall would do nothing to help.

In the USA, and following a slump in consumer confidence from the end of October that coincided with the correction on Wall Street, higher share prices last month clearly boosted morale again. The keenly watched services PMI picked up sharply, and although the manufacturing PMI dipped slightly it is still firmly in expansion territory. Services represent more than 60%of the economy. The services confidence index even rebounded in the euro zone, but the slowdown in Germany kept the manufacturing index close to the 50 point mark that represents neutral sentiment.

Higher share prices lift American morale



Services activity set fair

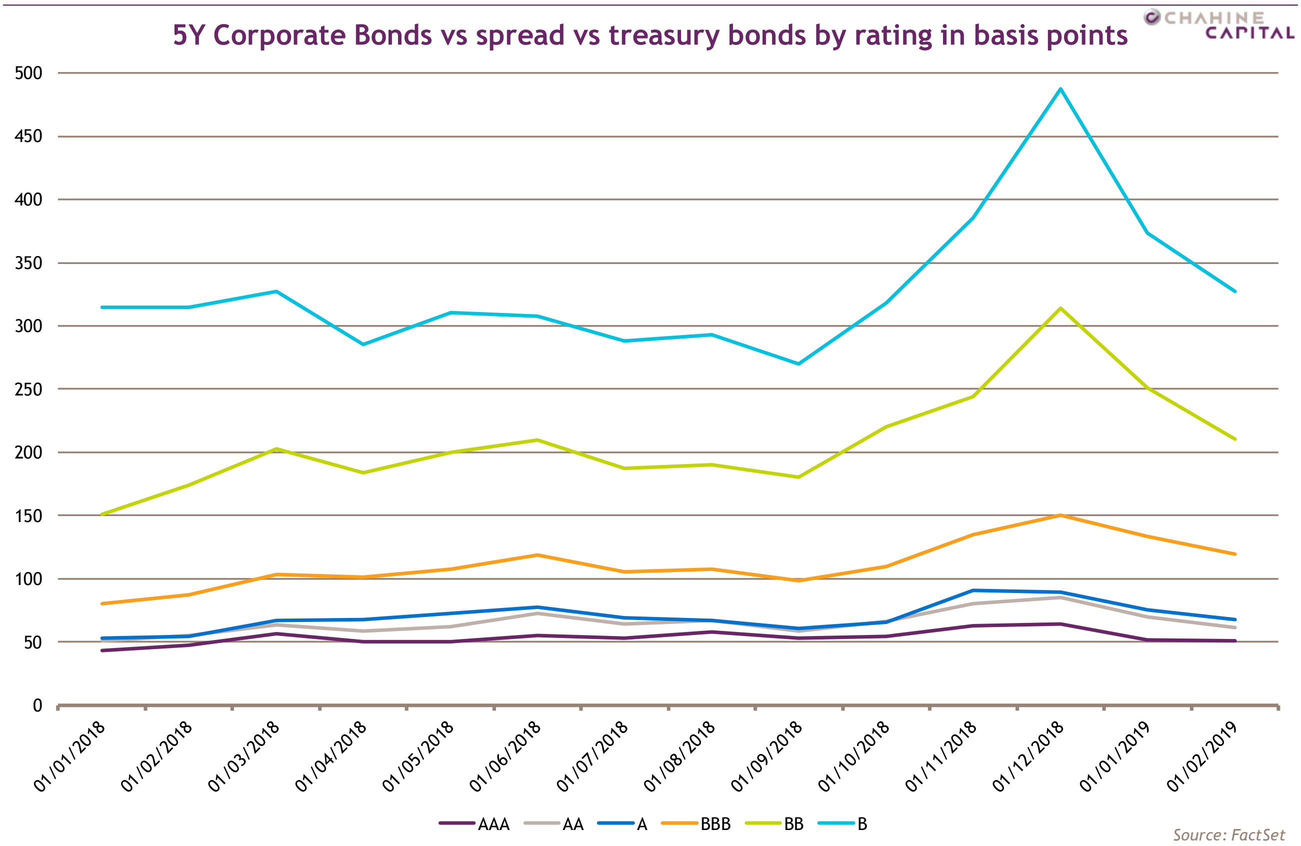


Several other US indicators are very positive, including labour market statistics. A rising participation rate is testament to the abundance of jobs.

The markets also appear reassured by the likely removal of a no-deal Brexit from the range of possibilities open to the UK and EU. There is a high probability that the UK will be tied closely to Europe for many years to come.

The credit markets offer another sign of renewed confidence. Fears of recession late last year had pushed spreads for the riskier borrowers significantly higher, and investors shifted into government bonds. Our research team's chart (below) shows just how fast riskier credits lose their shine at the merest mention of slower economic growth. The worse the risk, the more the spread tends to rise. We observe that single B credits paying an average 300bp over Treasuries had to pay 500bp during the correction, but also that their spreads have declined rapidly – and almost to their pre-correction levels – since. In contrast, triple A spreads hardly moved through the period.

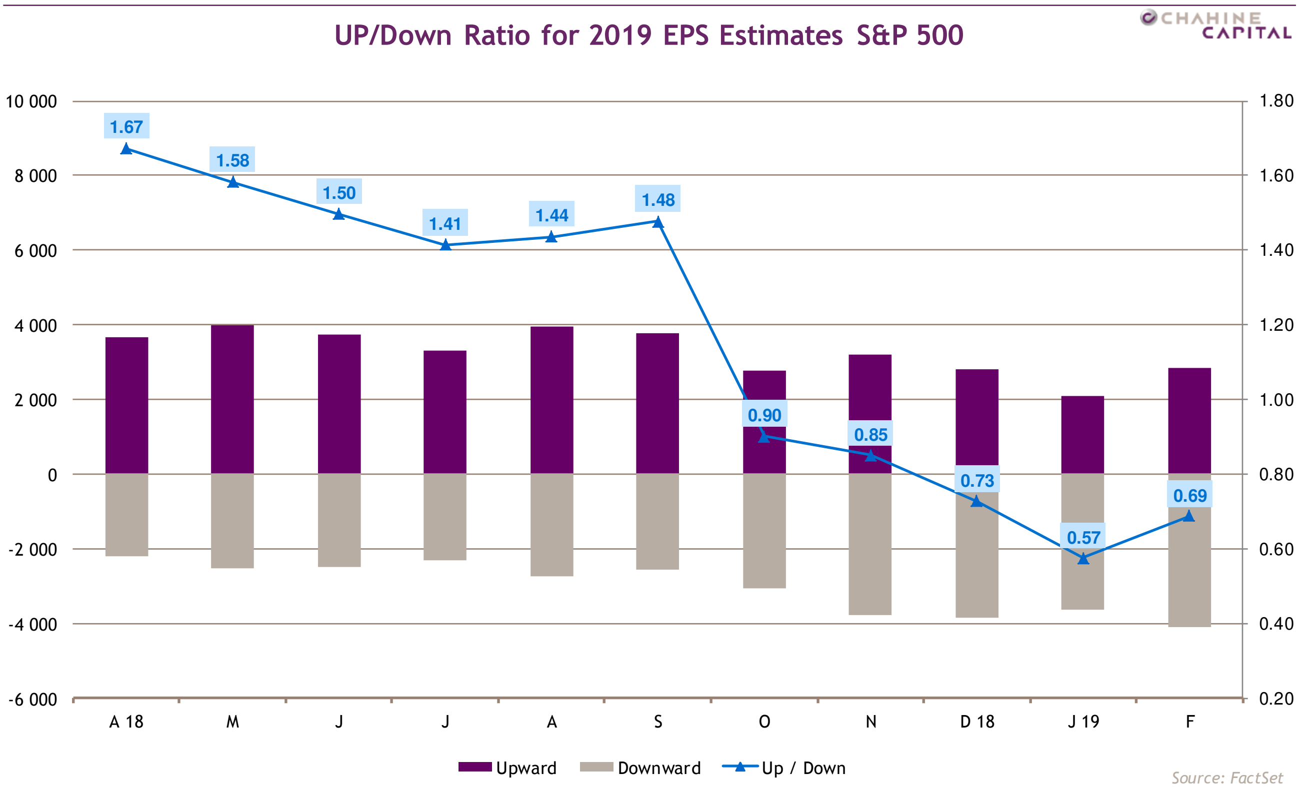
Credit risk back to normal



Earnings estimates settle down

A more stable economic outlook has favoured a more settled view of US corporate profits, which together with interest rates underpin our market valuations. Analysts have been revising their estimates of future profits down ever since share prices started sliding at the end of November; Q4 results confirmed these revisions. By the end of February, with almost all Q4 numbers in, the pace of revisions to 2019 estimates had started to slow and our up/down revisions ratio has climbed from 0.57 to 0.69. It had got as high as 1.48 in September 2018, when euphoria over tax reform was at its height.

A reversal in the up/down earnings estimates ratio



Source: FactSet

The table below shows the main ratios for the S&P 500 index, which accounts for 59% of the world's developed markets' capitalisation. The market consensus on EPS growth in 2019 has been revised significantly lower, dropping from 10% to 3.3% over the past month alone. Our own calculations had anticipated this sort of figure and our estimate has stabilised at 2.1%. We may have to revise it up in the light of recent increases in oil prices, which will affect an energy sector that was largely responsible for most of the downward revisions in the first place. Investors appear to be looking for just that, as the sector has been among the best market performers since the start of the year. Excluding energy, the consensus estimate of EPS growth is 4.3%. The best-performing stocks are industrials, reflecting the fact that they are also expecting some of the biggest jumps in profits: up 10%, led by Boeing, airlines and pure industrials such as Caterpillar and Deere.

The financial sector is reporting huge profits (no less than $34 billion for JP Morgan!) but has the lowest sector PER at 11.8x 2019. IT is not a stellar performer so far in 2019, appreciating just 1.3% with an above-market PER (18.1). The main culprit is the Chinese trade war; major groups such as Apple, Micron, Western

Digital, Applied Materials, NVIDIA, Lam Research, Texas Instruments and Seagate Technology are reporting lower profits. In contrast, firms less dependent on China – Microsoft, Cisco, Visa, MasterCard – are posting record earnings. The discretionary consumer sector includes Amazon and held up well during the correction; it also boasts Nike, Booking.com and Starbucks, which are looking at double-digit growth.

A number of companies previously classified as IT are now in the new communication services sector, notably Netflix et Google. Traditional media firms and film studios are struggling to keep up with Netflix, which has revolutionised TV by allowing consumers to pay for what they want rather than take what they are given along with endless adverts. The sector also includes Facebook, which has problems and faces a loss of interest among young consumers. The telecoms sub-sector is not attracting much investor interest on Wall Street (or anywhere else, for that matter).

Profits up 3.3% in 2019, and 4.3% ex-energy

	Weight vs	Perf		Weighted P/E		% Wted EPS Chge			Div Yield	Revision vs M-2%	
	Msci world	2019	2018	2020	2019	2020	2019	2018	2019	Fiscal 20	Fiscal 19
S&P 500	58.7%	11.9%	-6.2%	15.1 x	16.9 x	11.6%	3.3%	21.8%	2.07%	-0.5%	-0.7%
S&P 500 ex Energy	55.6%	11.7%	-5.2%	15.1 x	16.8 x	10.7%	4.3%	18.9%	1.99%	-0.5%	-0.6%
Consumer Discr.	6.1%	12.0%	0.7%	18.2 x	20.6 x	13.4%	7.3%	18.1%	1.41%	-0.4%	0.2%
Consumer Staples	4.6%	7.0%	-11.3%	17.1 x	18.4 x	7.3%	2.5%	12.2%	3.13%	-1.6%	-1.7%
Energy	3.1%	15.2%	-20.2%	14.7 x	19.0 x	28.9%	-13.2%	105.6%	3.43%	-0.5%	-3.4%
Financials	7.5%	11.5%	-14.8%	10.8 x	11.8 x	9.8%	7.9%	28.2%	2.30%	-0.3%	-0.5%
Health Care	8.6%	7.2%	4.6%	14.7 x	16.2 x	10.0%	4.5%	13.9%	1.74%	-0.7%	-0.8%
Industrials	5.7%	18.2%	-15.0%	14.4 x	16.0 x	11.8%	10.2%	18.3%	1.99%	0.0%	-0.5%
IT	12.0%	14.8%	1.9%	16.2 x	18.1 x	11.6%	1.3%	19.3%	1.63%	-0.7%	-0.4%
Materials	1.5%	8.5%	-16.3%	14.0 x	15.8 x	13.0%	-2.6%	28.3%	2.28%	-1.9%	-1.7%
Real Estate	1.7%	11.5%	-5.6%	38.9 x	42.7 x	9.7%	-18.2%	14.6%	3.44%	-0.4%	-2.1%
Comm Services	6.0%	11.8%	-7.8%	15.9 x	17.7 x	11.5%	4.1%	18.6%	1.47%	0.1%	-0.5%
Utilities	1.8%	7.8%	0.6%	17.3 x	18.2 x	5.3%	-0.8%	10.1%	3.48%	-0.3%	-0.3%
Russell 2000	6.0%	17.8%	-12.3%	19.7 x	24.5 x	24.7%	12.3%	33.7%	1.58%	-3.4%	-4.3%
NASDAQ Composite Index	27.6%	14.5%	-3.9%	19.0 x	22.2 x	17.2%	3.4%	22.7%	1.18%	-1.8%	-2.0%
NASDAQ-100 Index	19.7%	13.0%	-1.0%	17.7 x	20.2 x	14.4%	3.7%	20.1%	1.15%	-1.1%	-1.3%

Benchmarks source iShares ETF - Data as of 01/03/2019

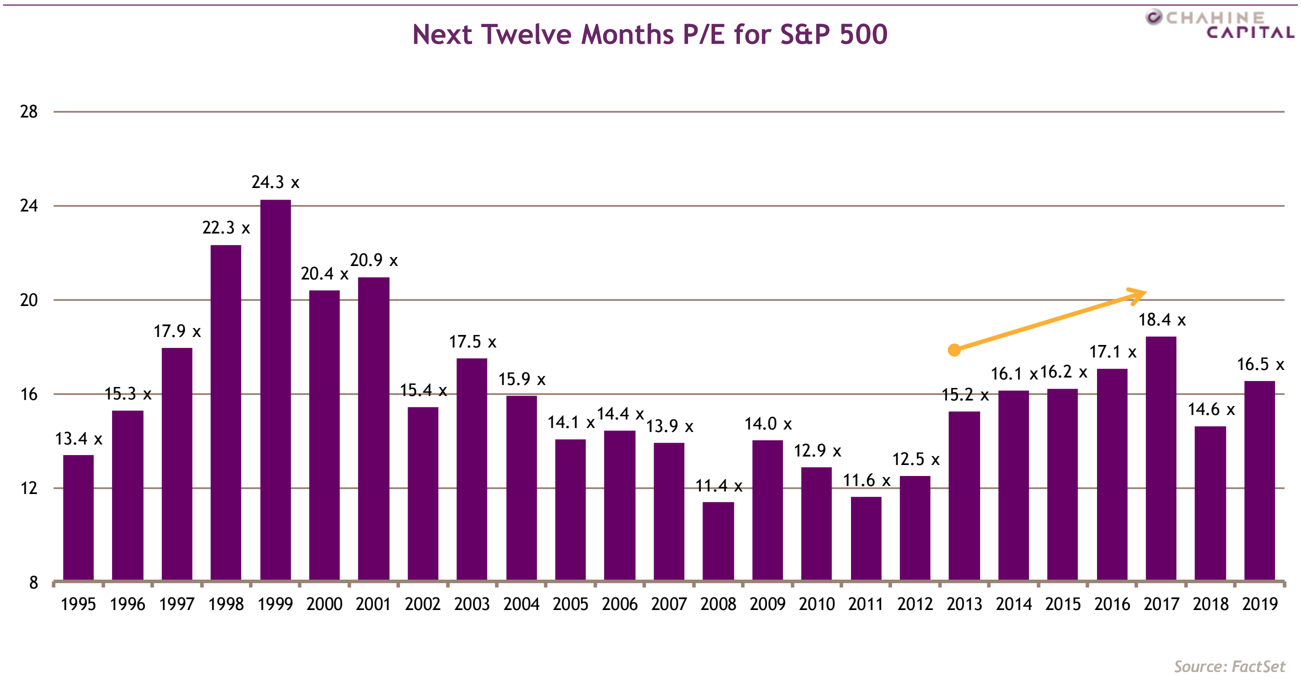
In the meantime, the Russell 2000 small cap index has rebounded strongly after a very poor 2018. Small cap profits climbed 33% in 2018, far outstripping large caps, and are currently expected to rise another 12% this year. Given downward revisions, that forecast is likely to be reduced, however.

All this goes to show that relatively low profits growth in 2019 masks the fact of high growth potential for some companies and sectors. This is why analysts believe that EPS will jump 11.6% in 2020 after a pause this year. We think that figure is overoptimistic and would pencil in 9% instead.

Low interest rates warrant high PERs

S&P 500 PERs hit recent highs in late 2017 and through 2018. The correction at the end of last year reduced its 12-month forward PER (i.e. for 2019) to 14.6. It is now 16.5, which is the weighted average of ten months in 2019 and two in 2020. As the chart below shows, the period between 2013 and 2017 corresponds to a cycle noted between 2004 and 2007, and a number of observers are worried about the sizeable hike in PERs between the two. But they usually forget that the 30-year rates used to calculate present values of future profits were not at all similar, at around 5% in the 2000s and below 3% more recently. That change means that the price of a 30-year bond would have appreciated 39%. It would be more logical to give a stock's infinite cash flows an actuarial present value, and therefore a PER greater than that 39% assuming identical future cash flows. This is why our risk premium model is based on a combination of future cash flows and a discount rate – the 30-year government bond rate – plus a constant 3% risk premium.

A sharp rebound in PER

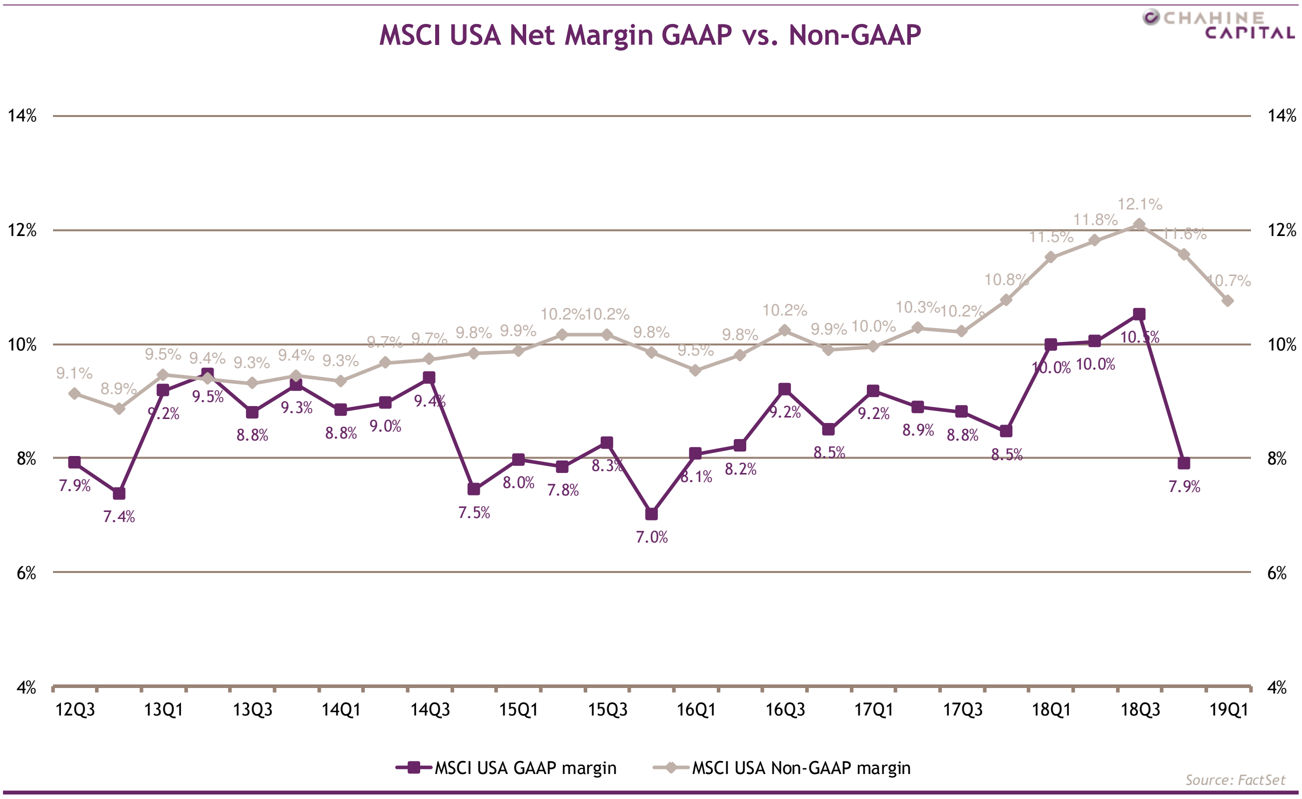


The determination of future cash flows is one of the most complex parts of our model. It starts with consensus earnings forecasts for the coming two years, which are then adjusted in the light of revisions, the macroeconomic situation and interest rates. We also take corporate profit margins into account, especially as they can hardly increase indefinitely. One of the observations we have been making for some time is that US margins have been setting new records because of the emergence of new companies in the new economy. The fact of stabilising margins now suggests that these profits will increase in line with the economy as a whole, i.e. between 3% and 5% per year given inflation and real growth. Our first quick take on Q4 profits highlights a massive gap between GAAP and the non-GAAP margins that analysts and firms use and abuse. GAAP margins tumbled from 10.5% to 7.9% between Q3 and Q4: we initially thought that there was some mistake, but not so. Heinz wrote down a massive amount of goodwill to leave it with a $6 billion loss, for example, for example, and its main shareholder – Berkshire Hathaway - took its share of the hit. Berkshire has written down its investments following corrections to firms like Apple and posted a $25 billion GAAP loss in Q4 after a tax-reform driven $32 billion profit. Asset depreciation also accounted for a

GAAP loss at Pfizer in Q4, and Allergan lost $4.3 billion for the same reason. These sharp adjustments at least show that American firms are looking to clean up their balance sheets, something less evident in Europe. The chart below highlights the impact of tax reform on profits and margins.

Non-GAAP margins exclude exceptionals, and while they soared in 2018 they also turned down in Q4. Consensus analysts expect a decline over 2019 as a whole.

A clean-up of US balance sheets



Wall Street assumes no recession, even in the medium term

We pay a great deal of attention to what the US market is pricing in. The 30-year rate inched higher last month, to 3.09%. All of the other parameters in our model are more or less unchanged. That gives us a year-end valuation for the S&P 500 of 2,700 points; it would be 2,744 points with a 30-year at 3%. The 8-year CAGR is an unchanged 3.4%, and it would need 4.5% to justify the index's close last week at 2,804 points. This is really the heart of the problem. The 3.4% we use for our model assumes there will be a recession or at least a slowdown in US growth during the coming eight years, which could in turn mean negative EPS growth. Our figure would be more than justified with even one year's recession or slowdown; the market's implicit 4.5% assumes economic growth of, say 2.2% or 2.3%, plus 2.2% or 2.3% in inflation without any change in margins over the period. Possible, of course, but is it realistic? Another interpretation is that the market is making no guesses about what will happen in a year or two's time, let alone eight years, and the likely 2.2% inflation plus 2.5% growth in 2019 is as far as its reasoning goes!

The table below shows just how sensitive valuations are to changes in long rates. With a 30-year at 3.5% the index is valued at 2,492 points. Under the hypothesis of moderate recession, it could slide to 2,519 points with a 30-year at 2.75%, and that is close to the 2,351-point low hit on 24 December.

Toppish valuations in a calmer trading environment

S&P 500 - Valuation end 2019 *CAGR Compounded Annual Growth Rate from 2018*	30 Years Gvt bonds 2.75%	3.00%	**3.09%**	3.25%	3.50%
Mild recession: -7.1% in 2019, and 8% in 2020 - CAGR =1.6%	2 519	**2 393**	2 350	2 277	2 170
Implied Scenario CAGR 4.5% over 8 years	2 992	2 837	**2 784**	2 695	2 565
Base scenario: 2.1% in 2019 and 9% in 2020 - CAGR = 3.4%	2 895	**2 749**	**2 699**	**2 615**	2 492
Current Index S&P 500			**2 804**		

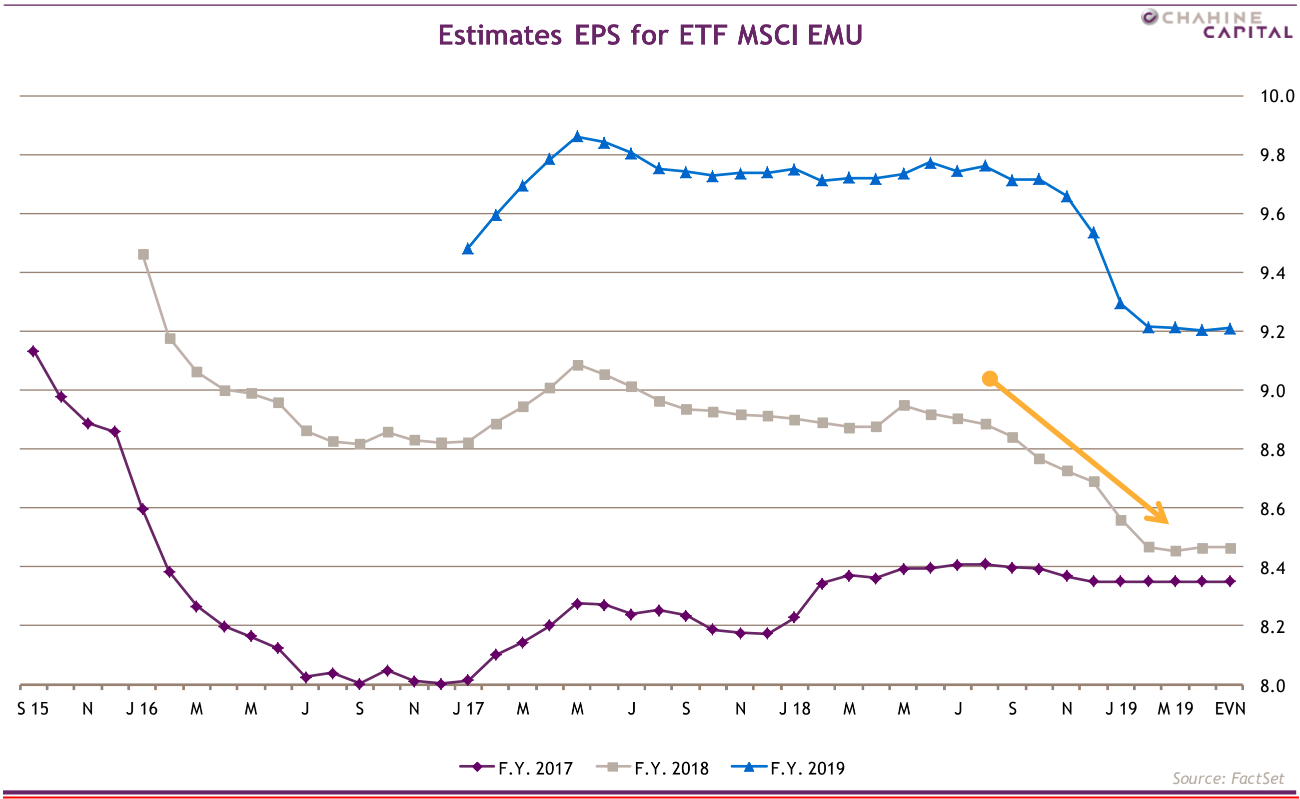
Readers will recall that we have been recommending that investors underweight their equity allocations relative to their benchmarks. At the end of December we suggested that investors that were underweight might consider buying again at the market's trough. What readers would be advised to do now depends on their particular circumstances. For our part, we are still underweight because we are able to identify profitable and less risky alternatives. We believe that equities are overpriced at these levels, although not in bubble territory, and that situation could persist for some time. In the event of another correction, a decision to re-enter the market would depend on the situation at the time. In the meantime, moderate investment in equities is simply sound management for buyers sitting on surplus cash. Our Digital funds are making up for past drawdowns and could be a good option for investors looking at Europe.

Disappointment on eurozone profits

The 2018 results season is not over in Europe. So far negative surprises largely outweigh the positives, and the expected 2% gain in EPS is itself subject to downward revisions. The market lacks credibility and nothing is being done to improve its transparency. Earnings projections have never been standardised, and the responsibility for that lies with listed firms. In the USA, companies provide guidance and explain which non-GAAP framework they are using; everyone knows where they stand and any surprises are measured against those forecasts. In Europe, there are as many forecasts as there are analysts, and the lack of quarterly results removes an opportunity to gauge performance.

The poor results published so far for 2018 partly reflect a trade war that has particularly affected the German car industry and German exports in general. National profits are down 8%. The few winners include Total, luxury goods (including Ferrari), Airbus and the rare IT firms such as Dassault Systèmes.

Virtually no earnings growth in 2018



This disappointment is consistent with the uncertainty generated by Brexit, trade disputes and the slower growth they imply. The ECB is still pumping liquidity into the system but it appears to be having little effect. They could always distribute it directly to France's yellow jacket protesters and boost consumption that way! Almost serious…

Our base scenario has improved somewhat, but the euro zone will need to find its second wind after Brexit and the coming European parliamentary elections. The EU needs to see whether budgetary and social integration - even if it takes 50 years - could yet impart a sense of direction.

Upside potential, but Europe needs fresh impetus

MSCI EMU - Valuation end 2019

CAGR Compounded Annual Growth Rate from 2018	**30 Years Gvt bonds**				
	1.00%	1.25%	**1.50%**	1.75%	2.00%
Depression scenario: -15% in 2019, and +4% in 2020 - CAGR =-7.6%	**107**	101	95	90	85
Implied Scenario: CAGR -6.0% over 8 years	134	126	**119**	112	107
Base scenario: 3% in 2019, and 5% in 2020 - CAGR = -4.6%	137	129	**121**	**115**	**109**
Current Index MSCI EMU			**119**		

Conclusion

The markets appear to have stabilised after an extremely volatile end to 2018. In line with a strong rally that has lifted the MSCI World 11.7% this year, the VIX index of volatility has fallen back to almost normal levels. The threat of recession has eased, at least for the time being, thanks to the Federal Reserve's return to an accommodating monetary policy and hopes of a settlement in the US-China trade war. The S&P 500's 20% correction in the final three months of 2018 was a severe setback that we see on average only once every six years: corrections of this magnitude have signalled recession slightly more than half the time. The market effectively forced the Fed to adjust its policy and the US yield curve now looks a little odd. It is slightly inverted out to the 5-year maturity and positively sloped beyond that point. That implies unchanged Fed rates for some years, but that could all change in the event of rising inflation. US economic growth was a robust 2.9% last year, including a 6% jump in investment. The trade deficit reduced growth, but the current balance is now only marginally negative at $124 billion, even with apparently elusive profits at GAFA and certain other firms.

Forecasts for world GDP growth this year appear to be stabilising at a very respectable 3.1%, after 3.3% in 2018. Persistently sluggish activity in the euro zone is more than offset by the resilience of the USA and several emerging economies. Germany is struggling, while France is posting slightly better growth following the budgetary sop thrown at the so-called yellow jacket movement. The American economy is the engine of international activity and is reporting a whole array of positive indicators, from rebounding consumer confidence to the services PMI and a rising participation rate. Credit markets have recovered a measure of calm and spreads on the riskiest borrowers have contracted. The prospects of a no-deal Brexit have faded and the UK could yet be tied to the EU for some years because of the Northern Irish issue.

This backdrop has helped analysts to stabilise their earnings estimates, and the up/down revisions ratio has started to pick up again. The consensus forecast for American EPS growth in 2019 is 3.3%, and 4.3% excluding energy. Our own top-down hypothesis is an unchanged 2.1%. The consensus figure for 2020 is 11.6%; we are retaining 9%. The 12-month forward PER is 16.5, and comparisons with the 2000s show that the gains in the PER can be attributed entirely to a fall in the 30-year rate from 5% to 3%. Our S&P 500 valuation gives us a year-end objective of 2,699 points with a 30-year rate at 3.09% and a CAGR of 3.4%. The market's current level implies an 8-year CAGR of 4.5%, which could be justified by an inflation rate of 2.2% and 2.3% GDP growth.

The catch is that US profit margins are at their highs and massive asset depreciation slashed GAAP earnings dramatically in Q4. Non-GAAP earnings suffered far less. Given that there is every likelihood of a slowdown in the coming eight years that could dent profits, our more conservative CAGR is more comfortable. Being right two years down the line is not so comfortable, however! This is why asset allocation is not a matter of black or white but of playing at the margins. We happen to be moderately underinvested, but cash-rich investors would be advised to go with sound equity management. In Europe, our Digital funds have made good earlier losses. If another correction materialises, investors should look at the situation at the time and take decisions with our valuations in mind.

Jacques Chahine

STRATEGY OVERVIEW

Main ratios for markets and sectors as of 1/3/2019 (in local currency)

	Weight vs	Perf		Weighted P/E		% Wted EPS Chge			Div Yield	Revision vs M-2%	
	MSCI World	2019	2018	2020	2019	2020	2019	2018	2019	Fiscal 20	Fiscal 19
MSCI The World Index	**100.0%**	**11.3%**	**-10.3%**	**14.1 x**	**15.5 x**	**10.1%**	**4.6%**	**13.1%**	**2.63%**	**-1.3%**	**-1.6%**
MSCI USA	60.4%	12.3%	-6.5%	15.2 x	17.0 x	11.8%	3.3%	22.0%	2.04%	-0.6%	-0.9%
MSCI Japan	8.3%	8.3%	-15.8%	11.5 x	12.0 x	4.7%	1.0%	5.2%	2.67%	-1.9%	-2.0%
MSCI EMU	14.2%	10.8%	-14.5%	11.9 x	13.0 x	9.4%	9.0%	1.2%	3.77%	-0.8%	-0.9%
MSCI Europe	25.9%	10.6%	-13.0%	12.3 x	13.4 x	9.0%	9.2%	6.0%	4.00%	-0.4%	-0.9%
MSCI Europe ex Energy	23.9%	10.8%	-13.7%	12.6 x	13.6 x	8.3%	9.9%	2.8%	3.86%	-0.7%	-1.0%
MSCI Austria	0.1%	13.0%	-26.7%	9.3 x	9.9 x	6.5%	-12.0%	11.4%	4.15%	-0.3%	-0.2%
MSCI Belgium	0.6%	16.4%	-24.9%	14.4 x	15.7 x	8.7%	12.5%	-0.2%	3.32%	-0.5%	-0.5%
MSCI Denmark	0.7%	10.6%	-12.4%	17.2 x	19.6 x	13.7%	2.0%	-1.3%	2.49%	-3.0%	-4.3%
MSCI Finland	0.4%	12.1%	-1.5%	14.7 x	16.6 x	12.7%	8.4%	2.3%	4.58%	0.1%	-0.9%
MSCI France	5.2%	11.3%	-9.7%	12.6 x	13.9 x	10.3%	9.2%	6.0%	3.54%	0.1%	-0.2%
MSCI Germany	3.7%	9.6%	-20.2%	11.1 x	12.1 x	8.7%	10.8%	-7.8%	3.57%	-1.9%	-1.3%
MSCI Great-Britain	6.0%	5.5%	-12.7%	11.5 x	12.5 x	8.6%	3.4%	9.8%	4.95%	-1.0%	-1.3%
MSCI Ireland	0.2%	10.5%	-23.5%	13.6 x	14.6 x	7.8%	-1.0%		2.08%	-1.2%	-1.6%
MSCI Italy	1.0%	12.1%	-15.1%	9.4 x	10.2 x	9.3%	6.5%	18.2%	4.92%	-1.6%	-2.5%
MSCI Netherlands	1.3%	11.9%	-10.9%	13.3 x	14.7 x	10.5%	3.4%	8.1%	3.41%	0.1%	-0.8%
MSCI Norway	0.5%	7.3%	-6.0%	12.2 x	14.2 x	15.8%	1.5%	19.7%	4.66%	-2.0%	-5.6%
MSCI Spain	1.4%	8.2%	-15.0%	10.8 x	11.6 x	7.1%	13.4%	-5.5%	4.76%	-1.0%	-0.5%
MSCI Sweden	1.1%	12.5%	-8.1%	14.3 x	14.5 x	1.4%	32.3%	-6.7%	4.19%	1.0%	-4.2%
MSCI Switzerland	3.2%	12.2%	-10.1%	15.1 x	16.4 x	8.5%	12.1%	25.9%	3.32%	0.1%	-0.7%
MSCI Europe Consumer Discretionary	3.0%	15.1%	-17.5%	11.2 x	12.0 x	6.6%	8.9%	-3.2%	3.47%	-1.9%	-1.7%
MSCI Europe Consumer Staples	3.7%	10.1%	-11.3%	16.0 x	17.3 x	8.4%	10.3%	7.5%	3.24%	1.0%	1.1%
MSCI Europe Energy	2.0%	9.0%	-5.0%	10.2 x	11.7 x	15.3%	3.0%	49.1%	5.67%	2.2%	0.0%
MSCI Europe Financials	4.7%	10.9%	-21.8%	9.3 x	9.9 x	6.8%	12.4%	7.0%	5.39%	-1.4%	-2.1%
MSCI Europe Health Care	3.1%	9.3%	-2.5%	14.8 x	16.2 x	9.6%	2.6%	6.8%	3.15%	0.5%	0.3%
MSCI Europe Industrials	3.5%	12.5%	-15.0%	14.1 x	15.5 x	10.1%	11.5%	2.0%	3.02%	-0.7%	-0.7%
MSCI Europe Information Technology	1.3%	13.5%	-8.2%	16.5 x	19.7 x	19.0%	12.7%	12.4%	1.65%	-0.6%	-1.7%
MSCI Europe Materials	1.8%	14.0%	-16.4%	12.7 x	13.5 x	6.1%	10.7%	0.9%	3.91%	0.1%	-1.0%
MSCI Europe Real Estate	0.3%	8.7%	-17.5%	13.8 x	13.3 x	-3.8%	-1.8%	-2.5%	4.93%	-2.3%	0.9%
MSCI Europe Communication Service	1.3%	-0.1%	-10.7%	12.3 x	13.5 x	9.6%	6.6%	-4.2%	5.28%	-0.6%	-1.6%
MSCI Europe Utilities	1.2%	7.6%	-1.3%	12.8 x	14.3 x	11.8%	16.9%	-13.8%	5.36%	-0.1%	-0.6%

Benchmarks source iShares ETF - Data as of 01/03/2019

Disclaimer

We do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information provided in this publication. You must evaluate, and bear all risks associated with, the use of any information provided here, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of the publisher. The publisher or one or more of its employees or writers may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED “AS IS,” AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, J.CHAHINE CAPITAL AND ITS AFFILIATES, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURANCY, COMPLETENESS, AND NONINFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW,NEITHER DIGITAL ANALYTICS NOR ITS AFFILIATES,NOR THEIR RESPECTIVE OFFICERS, MEMBERS DIRECTORS, PARTNERS, BUSINESS ASSOCIATES OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PERSON IS ADVISED OF THE POSSIBLILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.