



asset allocation
masterclass

[Asset Allocation Masterclass 2010]

The outlook for global equities

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CONFERENCE

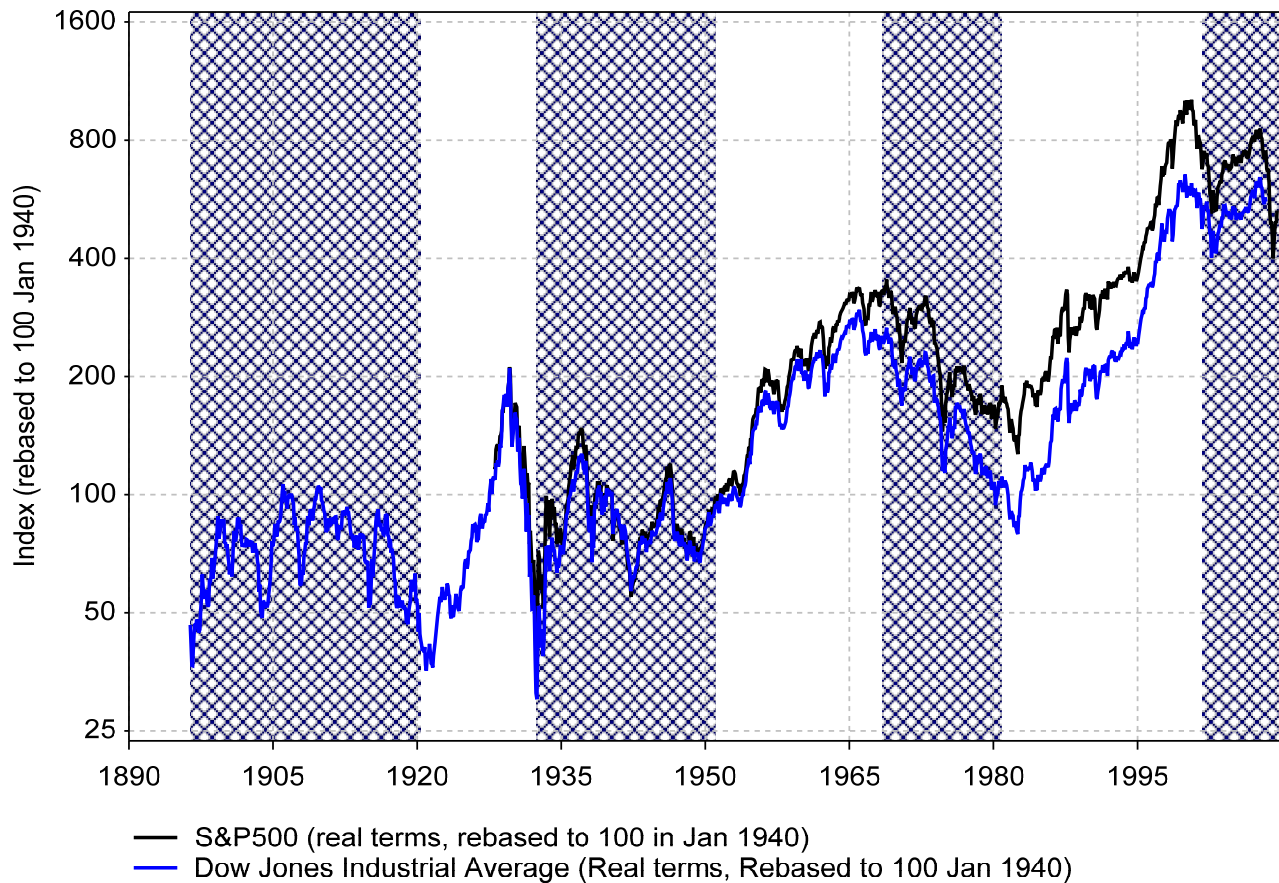
Tuesday 24 – Thursday 26 August 2010 | Sydney

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1. Cyclical bull market or bear market rally?
2. Phase I, II and III of a stylized cyclical bull market
3. Entering Phase III?
4. EM vs. DM
 - Structural tailwinds vs. structural headwinds

Super Cycles – the very long term

S&P500 & DJIA inflation adjusted indices (1896 to 2009)



US S&P500 and Dow Jones industrial Average (inflation adjusted) – long term performance 1896 to 2009

Criss-crossed areas represent Commodity Super Cycles, i.e.

- 1) 1896 – 1920
- 2) 1932 – 1951
- 3) 1968 – 1980
- 4) Oct 2001 - current

Cyclical Equity Bear Market = Anticipation of Recession => What Drives Recessions?

1. Shocks

- i. Oil price shocks
- ii. Inflation shocks

2. Excess

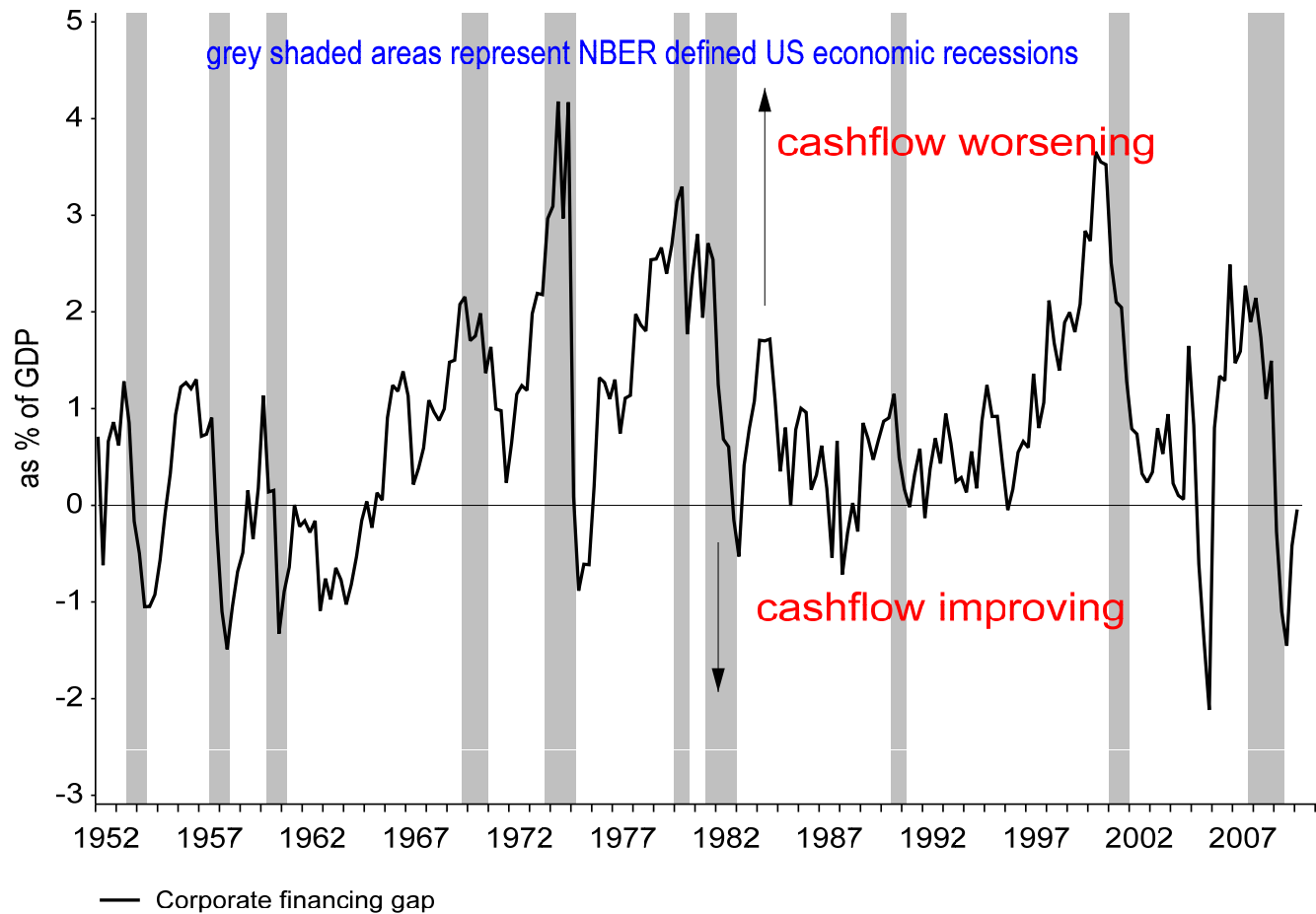
- i. Overstretched companies
- ii. Overstretched, & therefore vulnerable, financial sector

3. Bubbles bursting

- i. e.g. 2000 stock market bubble
- ii. 2007 Housing bubble

Cash Rich Companies & Economic Expansions

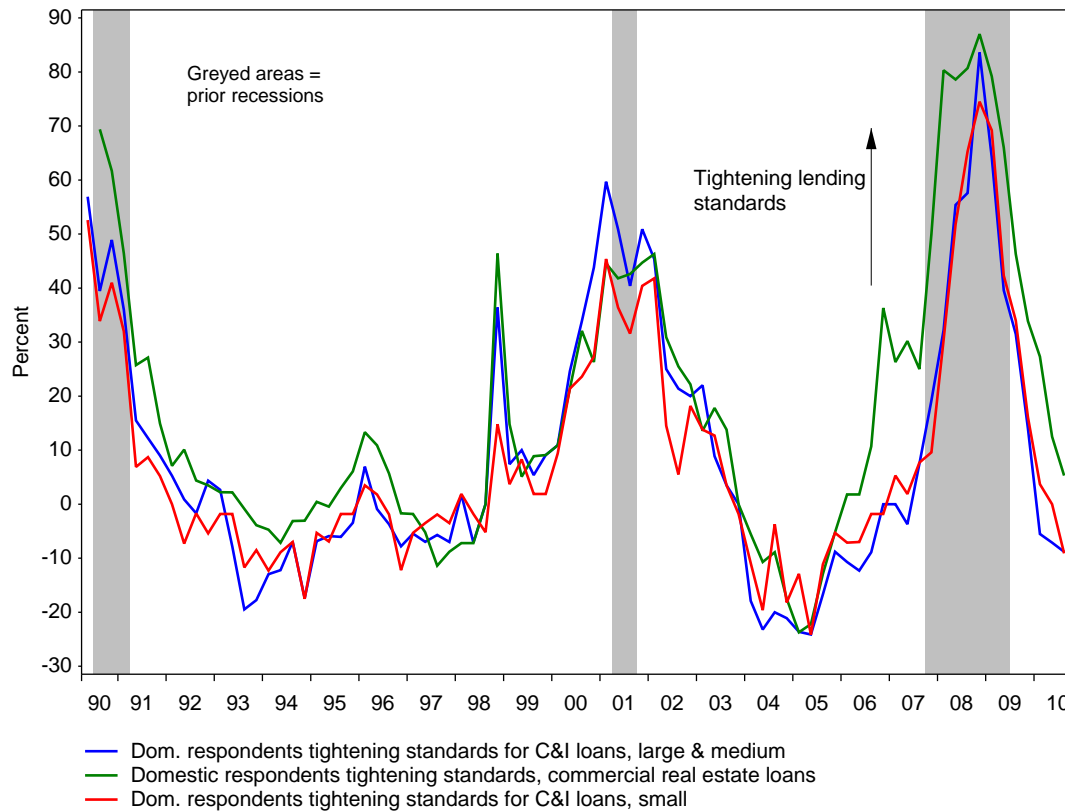
US Corporate financing gap (as % of GDP) shown with recessions



Source: Longview Economics, US Federal Reserve Flow of Funds, EcoWin

Cyclical Bull Market or Bear Market Rally?

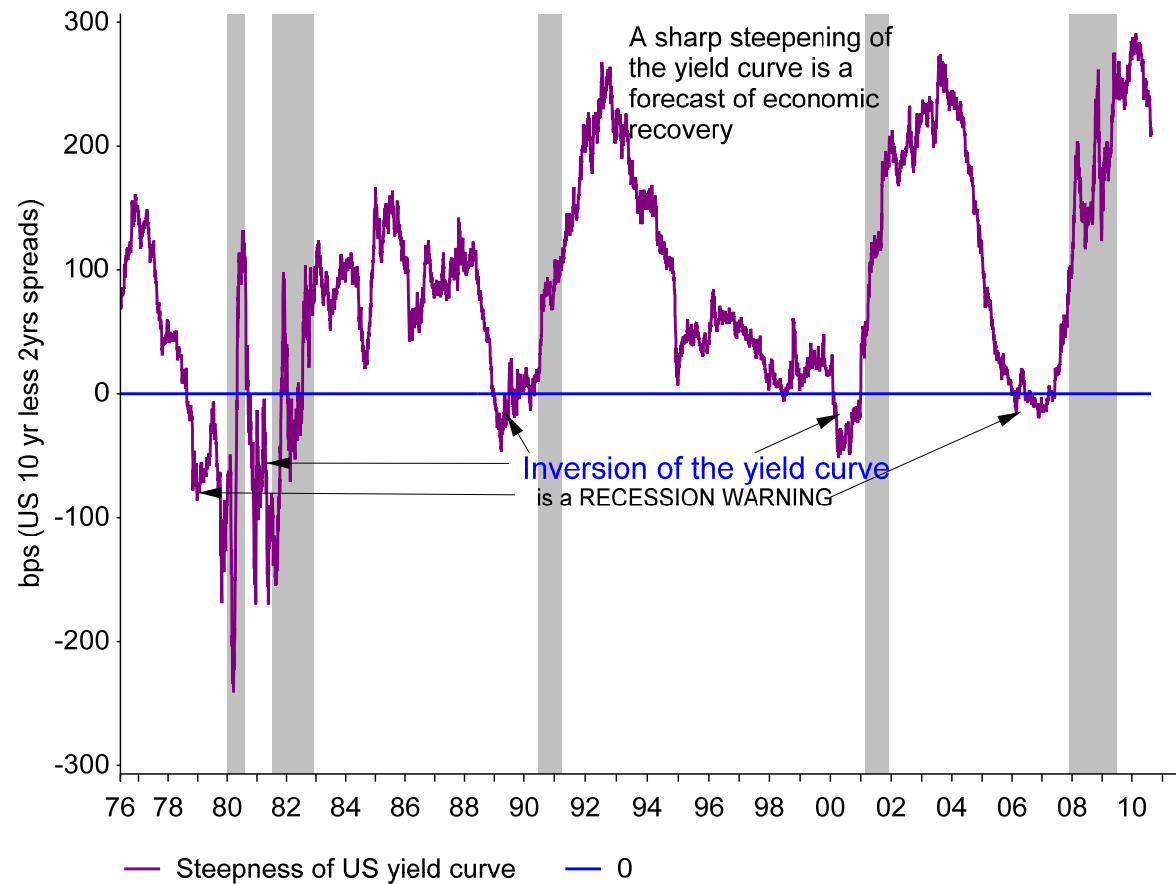
Macro is key – Mini Cycle or Renewed Recession?



Source: Reuters EcoWin

Yield Curve = Efficacious Economic Forecaster

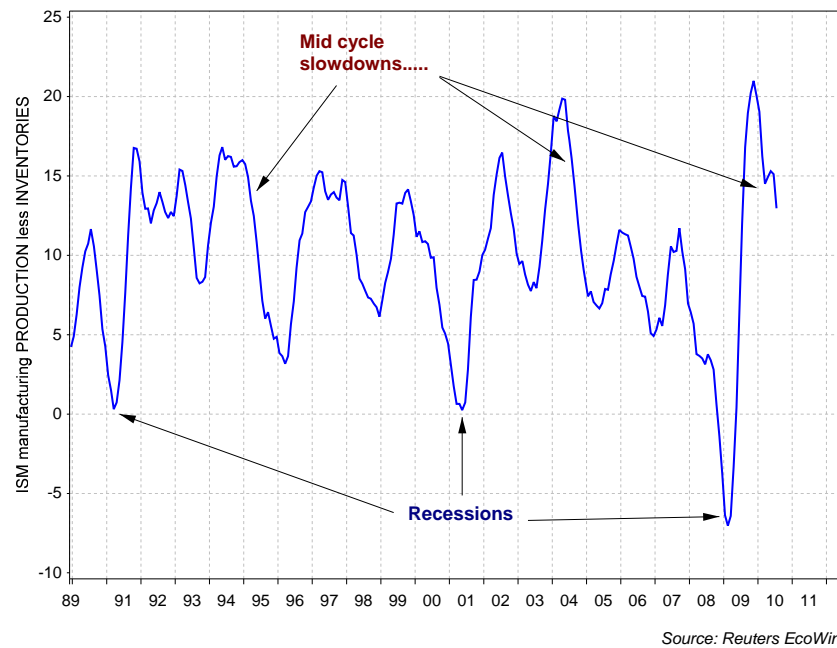
Steepness of US yield curve & US economic recessions



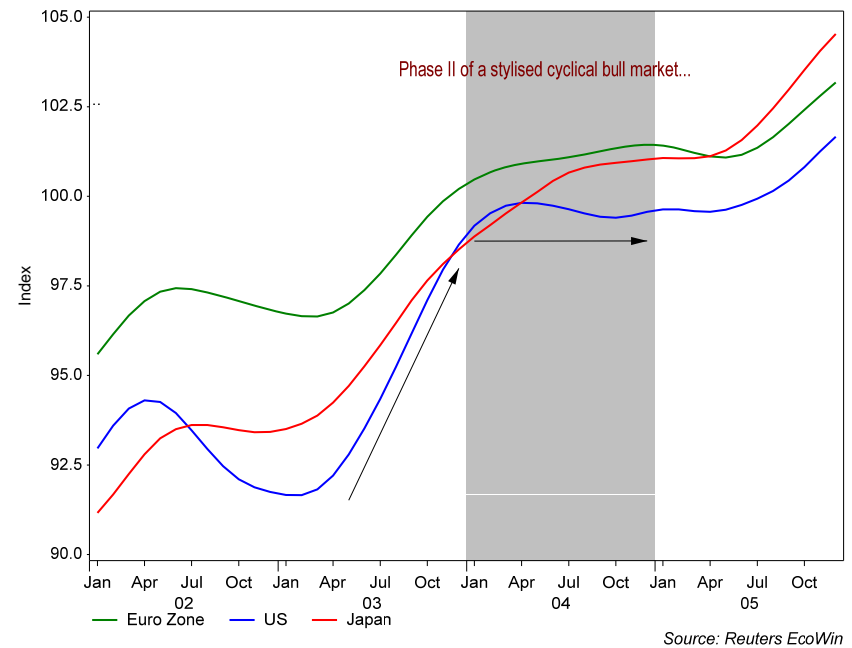
Source: Reuters EcoWin

Mid Cycle Slowdown

US ISM manufacturing: Production less Inventories (6 month moving average)

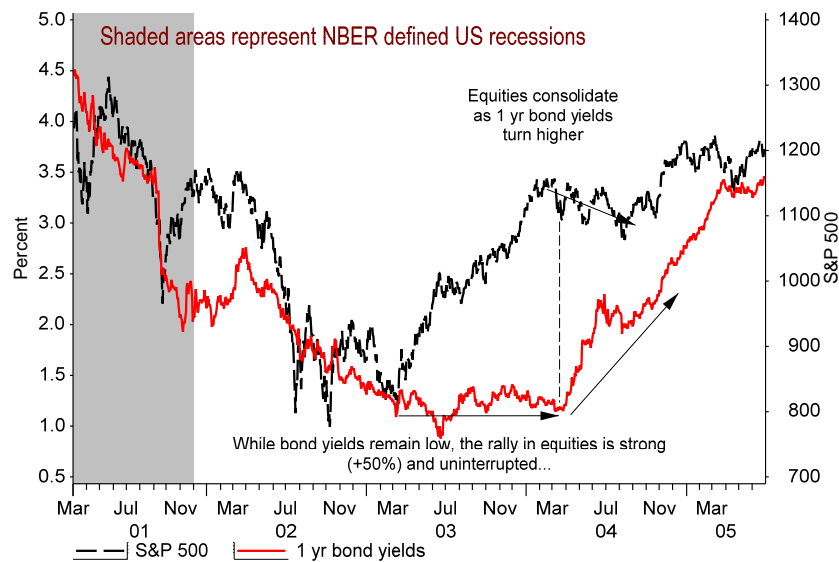


OECD LEIs – 2004 mid cycle slowdown



Phase II – last cyclical Bull Market

S&P 500 and 1 year US bond yields post the 2001 recession



Source: Reuters EcoWin

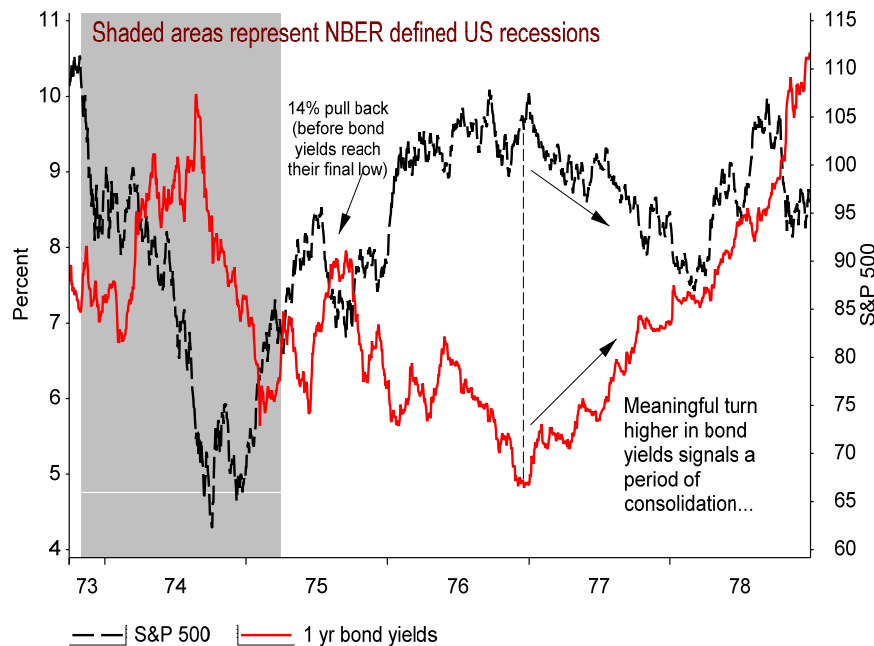
S&P 500 in 2004 (Phase II)



Source: Reuters EcoWin

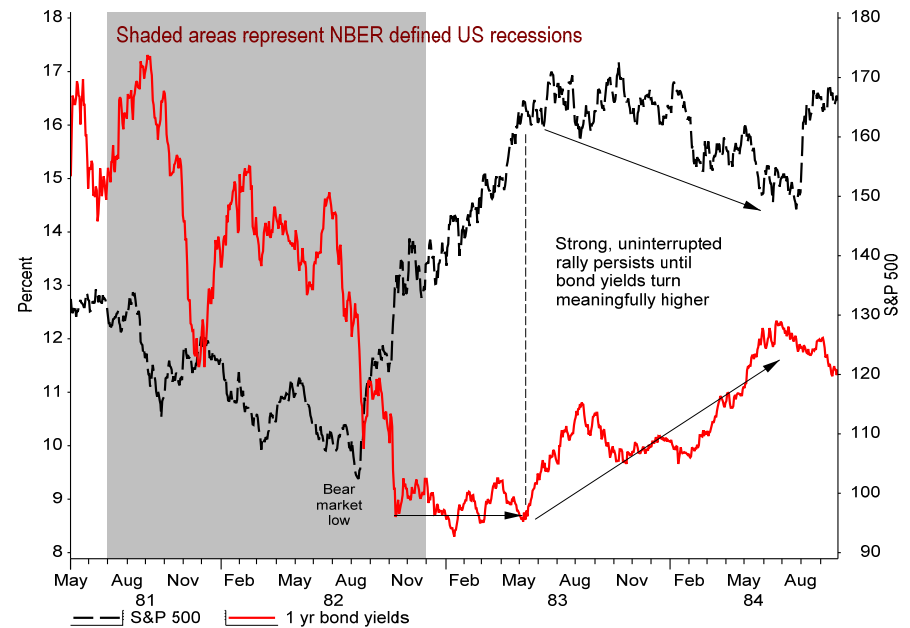
Stylized Cyclical Bull Markets – Phases II: Other examples

S&P 500 and 1 year US bond yields post the 1973-'74 recession



Source: Reuters EcoWin

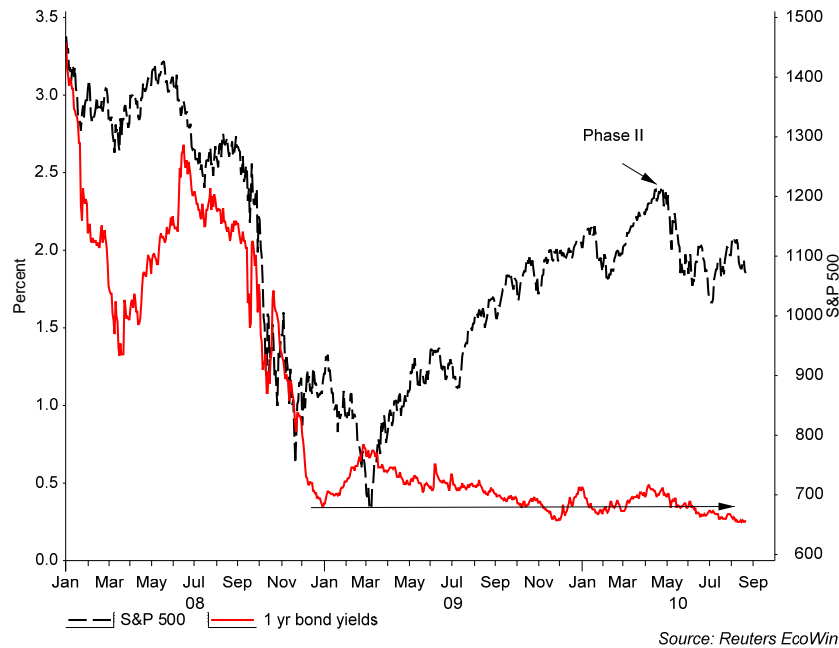
S&P 500 and 1 year US bond yields post the 1981-'82 recession



Source: Reuters EcoWin

Phase II?

US S&P500 vs. US 1 yr bond yields



Phase II in Europe (EuroSTOXX broad index)



Size of Phase 1 and size of Phase II

Phase I & II – S&P500

Bear market low	Phase I rally	Phase II pullback	Duration
Mar-09	80%	16%...so far	4 months
Mar-02	45%	8%	6 months
Oct-90	63%	9%	2 or 10 months
Aug-82	66%	14%	9 months
Oct-74	73%	19%	18 months
May-70	51%	14%	7 months

Source: Longview Economics

Timing Start of Phase III? - Key: Look East....

Shanghai Composite

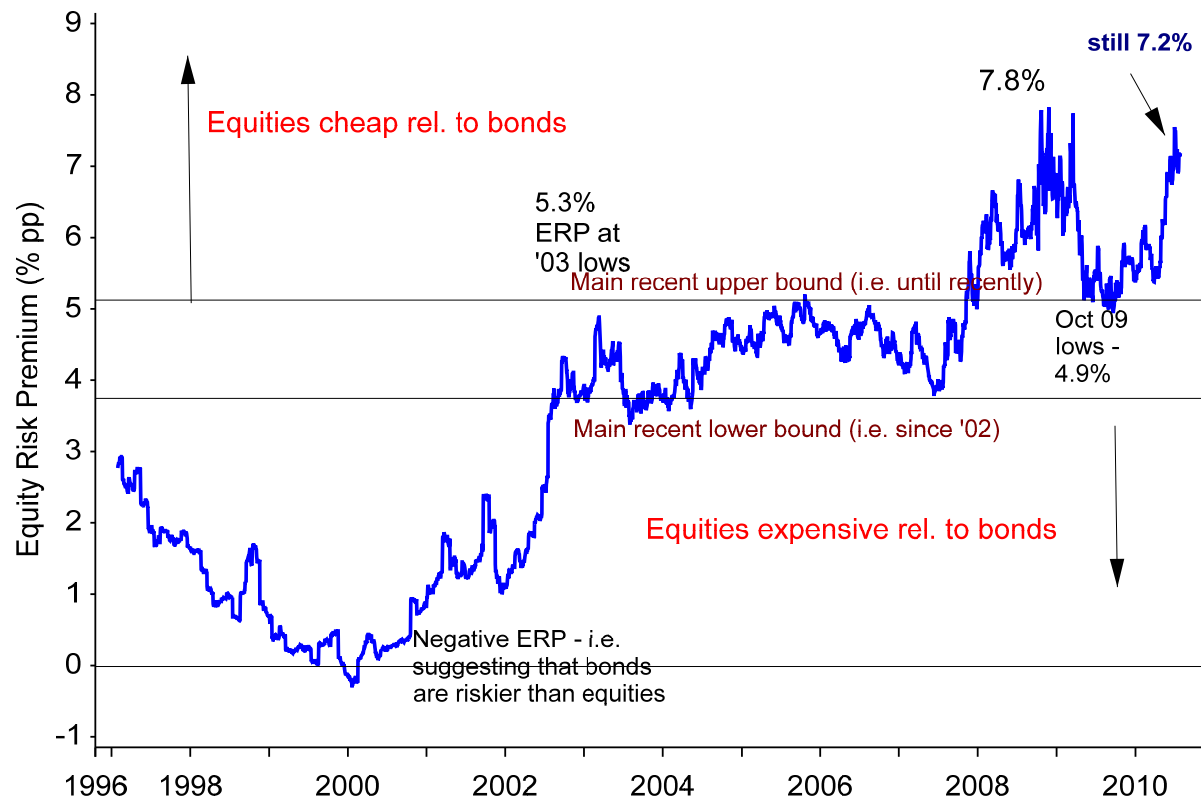


China, Shenzhen SE, Real Estate Index, Close, CNY



Equity Valuations – Compelling (esp. rel to bonds)

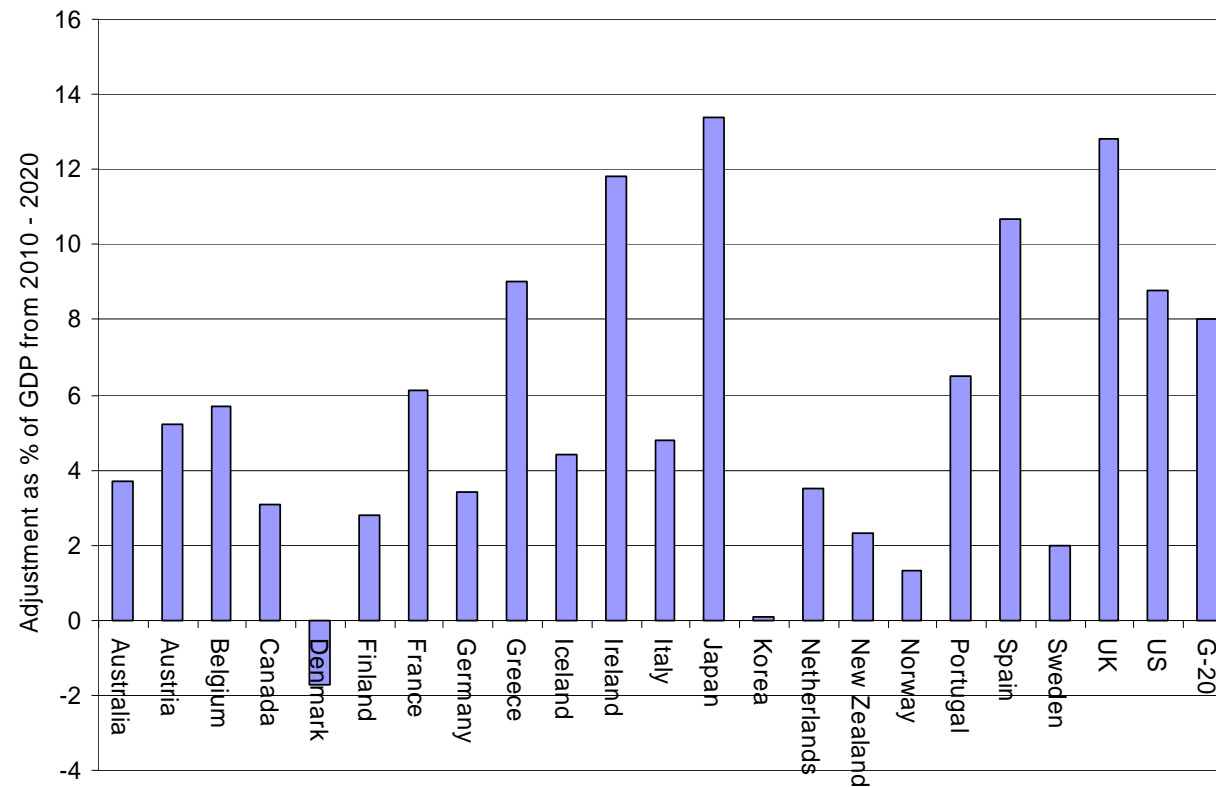
US ERP (%) – close to record highs



Source: Longview Economics, Reuters EcoWin

Structural DM Headwind:

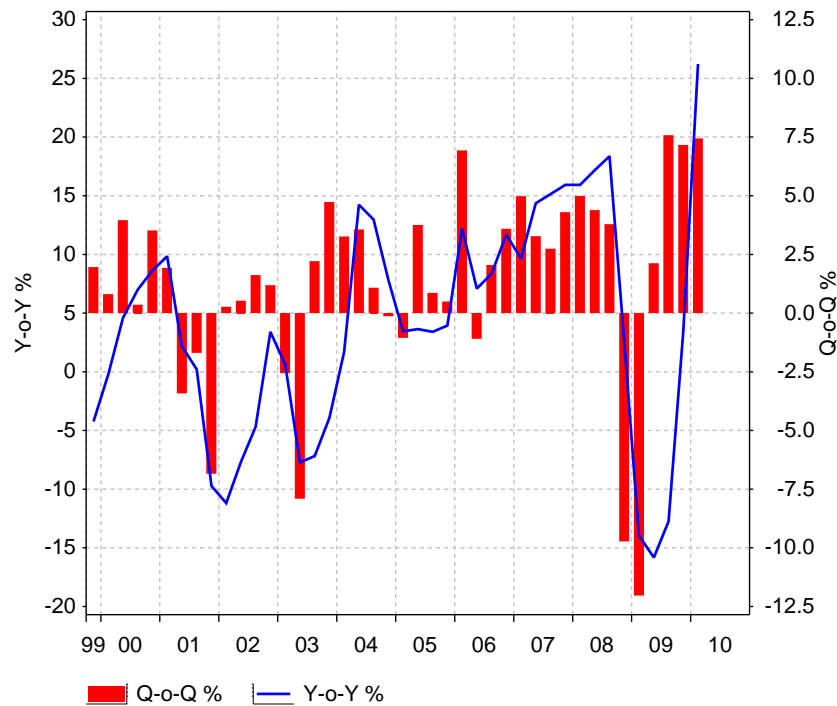
Required Fiscal adjustment as % of GDP –
Advanced economies



Source: IMF

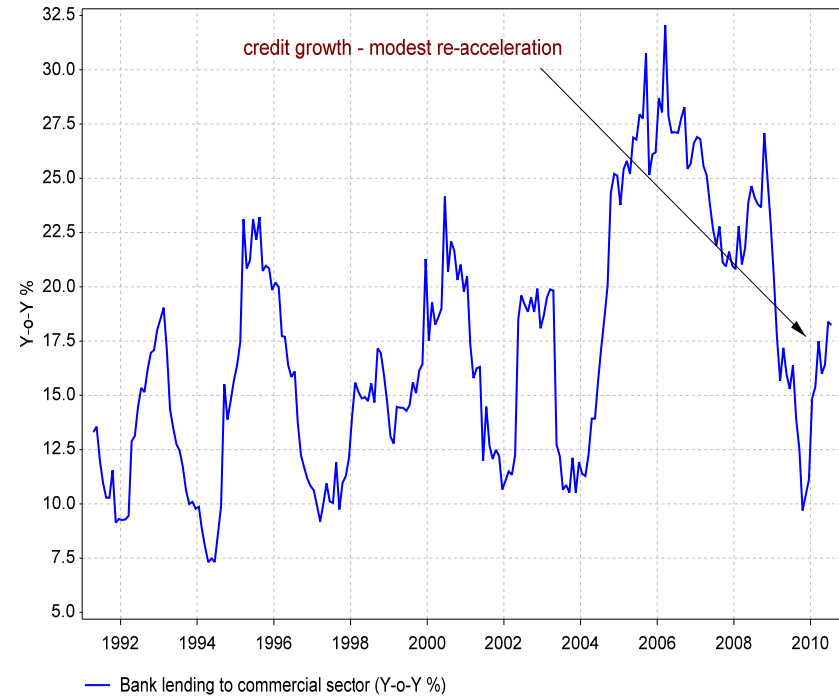
Switchover of global growth leadership: Emerging Market Leveraging

Brazilian Capex boom...



Source: Reuters EcoWin

Indian Corporate lending (Y-o-Y %)



Source: Longview Economics, EcoWin

Conclusion

- Cyclical bull market underway
- Classic Mid cycle (inventory led) slowdown
- Phase II in stylized cyclical bull market
- Asia/China to lead West into Phase III
- Emerging Markets preferred over Developed markets

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