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May 2016

EQUITY VIEWPOINTS

GLOBAL MARKET COMMENTARY

APRIL 2016 – MODEST GAINS FOR EQUITIES

Stocks rose early in the month, as investors reacted favourably to rising oil prices and signs of stabilisation in the global economy. Earnings concerns and some disappointing economic data appeared to weigh on sentiment later in the month, however. Performance among sectors in the Standard & Poor's 500 Index varied widely, with the energy sector surging nearly 9%, while technology shares fell over 5%. Value stocks outpaced growth stocks, while the smaller-cap benchmarks outperformed their large-cap counterparts. Markets also rallied on the strength of raw materials prices. European stocks showed some gains, partly due to the strengthening euro, but also because of relatively good early earnings results and modestly positive outlooks from key companies and industries.growth overseas, while reiterating the Fed's plan to move slowly and carefully in raising rates.

GLOBAL EQUITY VIEWPOINTS

UNITED STATES: Talk of a US recession remains, but we would stress that the consumer remains in a strong place. There has been a continual improvement in the labour market, moderate increases in wage inflation and a steady ongoing improvement in the housing market. Consumers also have lower debt levels and continue to benefit from lower energy prices. Given this, and notwithstanding the slow GDP growth reported for the last quarter of 2015, we do not believe that a recession is imminent.

Valuations remain 'reasonable' considering where we are in the economic cycle. The current dividend yield of roughly 2.3% is also superior to the yield of U.S. 10-year treasuries, and the S&P 500 is trading at a higher earnings yield than investment grade corporate bonds.

On balance, the health of corporate America remains strong, with balance sheets in aggregate having been meaningfully strengthened over the past several years. While it may be reasonable to expect recent wage growth to negatively impact overall levels of corporate profitability, we do not anticipate a meaningful decline.

Bull markets usually end with recession or due to valuation bubbles - we see no signs of either. The economy continues to grow, albeit at a slower pace than previous cycles, so we remain reasonably constructive, but the outlook going forward is inherently more stock-specific than it has been for some time.

EUROPE: Europe's modest economic recovery continues. Leading indicators such as the composite Purchasing Managers' Index still signal expansion. The weaker euro, falling energy prices and the ECB's economic stimulus measures are also helping in supporting economic growth.

While headline inflation remains low, we are likely to see a pick up as oil prices fall out of year-on-year comparisons. Even so, confidence that central banks can maintain a positive financial market environment has waned in some quarters. Markets will be looking for evidence that the ECB's recent financial package of stimulus measures has enough fire power to spur the Eurozone forward.

The meaningful increase in the asset purchase program to €80bn from €60bn per month, the inclusion of investment-grade corporate bonds, and a comprehensive new bank lending program ("TLTRO") could potentially be quite stimulatory. These measures provide actual liquidity and aim to encourage greater investment and risk-taking behaviour. But the measures also highlight the concerns about the potential fragility of the current European economic recovery, given the current weaker trends in global demand and pervasive deflationary forces.

In addition, moves to assert sovereign independence in Europe, notably the UK's referendum on EU membership in June, and efforts by Catalans to separate from Spain, may continue to unsettle investors. Uncertainty is likely to increase as we near the UK vote, and this may be reflected in greater volatility and potentially some shorter-term hiatus in economic activity.

Our focus on good-quality companies at attractive valuations continues to result in a tilt toward domestically generated revenues. However, in recent months, we have added a number of high-quality companies with exposure to emerging markets after some steep falls.

JAPAN: Concerns about global economic growth, the outlook for China, and renewed yen strength, have caused some investors to re-evaluate the case for Japan in recent months. However, we would remind investors how far Japan has come in a relatively short period of time, especially when you consider the quality of the Japan equity rally relative to other markets.

Japan's rally over the last three years has been backed by a real recovery in corporate profits, in contrast to being driven by the expansion of multiples (i.e., valuations rising). Such

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fundamental improvement has been a rare feature within global equity markets.

This trend should help investors feel that material change is happening in Japan, but the weakness of the yen has been front and centre for much of the last few months. The pattern of yen weakness over the past three years has stalled, and recent strengthening goes against many predictions of further weakness. This matters because equity returns have become increasingly correlated with the weakening currency. Central to this is the fact that currency weakness has boosted corporate earnings growth and, in turn, resulted in the high-quality equity market rally that has been so important to the case for Japan.

Having held a view since late 2012 that the Bank of Japan's (BoJ) policy decisions would likely weaken the yen, our perspective today is of an increasingly unpredictable currency outlook. While we struggle to see any reason why the yen should meaningfully strengthen from here based on economic fundamentals, we have been examining our earnings expectations and will continue to do so in the event of the currency strengthening further.

It is important to make clear that we firmly believe that the valuation case for Japan still holds, and that Japanese corporate earnings growth is likely to exceed global peers. This view underlies many of our preferred stock ideas today. There is one note of caution, however, which is that further currency strength, if it transpires, will most likely begin to diminish expected growth in corporate earnings.

Japan remains cheap relative to peers, both in absolute terms and versus the previous cycle high in 2007. On this basis, current levels offer an appealing entry point for investors who are capable of sifting through the volatility for attractive stocks unduly caught up in a period of worsening sentiment.

EMERGING MARKETS: Emerging markets have been on an improving trend. A weakening in the US dollar, sounds of more global monetary easing, and some cyclical recovery in oil and commodities have helped calm markets. We are also seeing the first tentative signs of acceleration in emerging market growth.

We are encouraged by this, but remain focused on countries implementing meaningful reforms that are aimed at improving the quality and sustainability of their growth. India, Mexico, Indonesia, and even China have begun to implement important and much needed reform programs. However, the varying pace and success of those efforts in each country will continue to drive greater divergence in relative performance.

Key to our broad outlook is that dispersion within emerging markets. Our approach has always been to look at economies and stocks in a very granular way. Despite the overall slowdown, we would encourage investors to see through the negative headlines about economic growth and instead focus on the prospects of individual companies.

The most important risk factor for us is the evolution of corporate earnings. Valuations reflect pessimistic estimates for earnings growth and any positive surprise are likely to bring relief to markets. Companies will need to deliver over the medium- and long-term, however, to allay fears and bring about a re-rating of individual stocks and markets.

Importantly, the long term fundamental case for emerging markets remains in place. That has not changed. Emerging markets have endured some extreme headwinds in recent years, but many of those are now turning, or at least abating. Economic growth is set to improve and local EM currencies have adjusted. Many of the factors that have been cited as reason not to hold emerging equities are becoming less valid.

What is crucial today is time horizon and entry point. It is important to state again however that the past trajectory of EMs and winners at the stock level will not be the same going forward. What matters over time is the individual stocks you own and whether they are growing and undervalued. Outside of an unknown crisis, there is more potential upside today than before, and with a focus on fundamentals, there are abundant opportunities for experienced investors.

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