

Global equity strategy

Market outlook

September 2011

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We think there are five likely scenarios...

Macro scenarios and investment implications

Description	Probability	Latest direction	Catalysts	Growth	Market
Below-par growth and renewed QE	50%	↓	Fiscal tightening, coordinated policy action, GEM stops tightening, Euro muddles along (EFSF expanded, ECB purchases more Bonos/BTP), commodity prices fall	1-2% in the US, 0-1% in Europe, 3% globally	S&P 1,350. Continental Europe underperform. Buy quality growth, GEM consumer plays, index-linked proxies, software. Defensive-led bull market
Mild recession	20%	↑	Fiscal overkill, acute loss of confidence, credit crunch in Europe, oil and food prices stay high	GDP growth of minus 1% in the US and minus 2% in Europe, globally 1+%	S&P falls to 950, EPS fall by 20%. Defensives, I-L bond proxies and growth outperform
Severe recession - Euro break-up	10%	=	Core Europe stops supporting the periphery, possibly as a consequence of a French downgrade: disorderly defaults in the periphery	GDP declines c5% in Europe, 1% globally	S&P falls to 750 as EPS fall by 40%. Buy defensives, high FCF yield, low leverage, domestic Germany, peripheral European exporters, Swedish bonds
Quick fiscal integration in Europe caused by acute crisis	15%	↑	Acute crisis triggers policy response by ECB (more soft QE) and governments (Eurobond). Cost of bailout < cost of no bailout	GDP growth falls to zero but then recovers to 1-2% in the US, 0.5-1% in Europe, 3% globally	Euro and markets sell-off initially (S&P 950-1000), but after policy response equities rally (S&P 1,300-1350)
"Sunshine" scenario	5%	↓	Core Europe muddles through; risk appetite returns; real rates stay negative (potentially with further QE); China eases policy, enjoys 10% real growth; commodity prices fall as supply concerns ease	3%+ in the US, 2%+ in Europe, China 10%, c5% globally	S&P rises to 1,600 as cheap real assets re-rate. Strong cyclical rebound, banks biggest outperformers. Bond markets (except I-L) sell off.

We show our estimates for the fair value of the S&P based on ISM, credit spreads, GDP growth, bond yields and warranted ERP in each of the five scenarios

Fair value of the S&P under our different scenarios

Scenario	Prob.	ISM	BAA Credit Spread	US GDP growth	10Y BY	EPS growth	Warranted ERP (operating)	Fair value of S&P 500	PE on trend EPS
Core scenario	50%	50	350	1.5%	2.1%	7%	6.2	1350	16.7
Recession	20%	41	400	-1.0%	1.2%	-25%	7.1	950	11.7
Severe recession (Euro breakup)	10%	31	500	-4.0%	0.8%	-40%	7.5	750	9.3
Quick fiscal integration in Europe caused by acute crisis*	15%	45	450	0.0%	1.3%	-10%	7.2	1000	12.3
Sunshine scenario	5%	57	230	3.5%	3.5%	18%	4.7	1600	19.8
We assume LT growth of 4.8%, Payout ratio of 45%. * This scenario reverts to core scenario after policy response								weighted average	1220

New targets and weightings

Equity market index targets

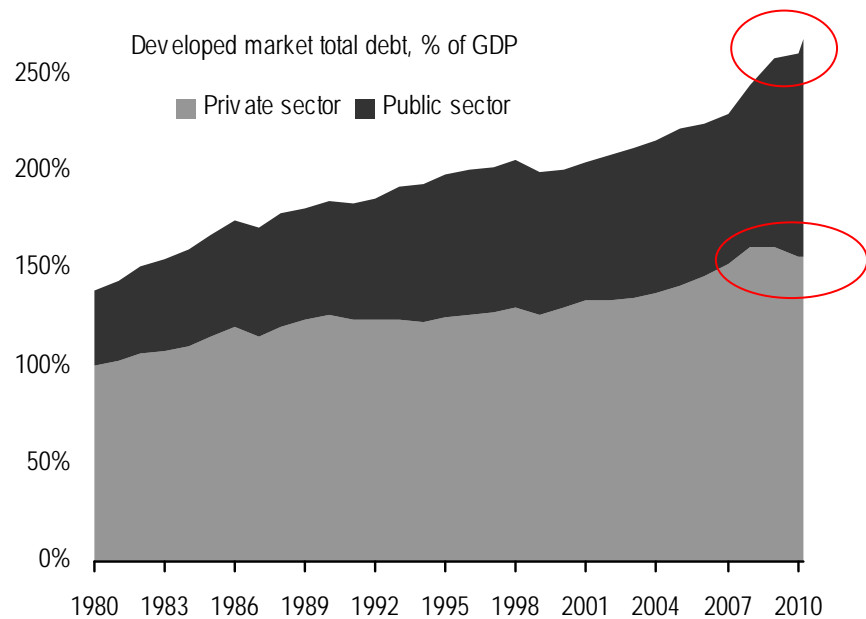
Credit Suisse Global Strategy - Index targets					
Market	Current	end-2011	Price return, end-2011E	end-2012E	Price return, end-2012E
S&P 500	1,174	1,220	4%	1,300	11%
DJ Euro Stoxx	221	225	2%	235	6%
FTSE 100	5,292	5,500	4%	5,900	11%
Nikkei 225	8,951	9,500	6%	10,250	15%
MSCI EMF GEM	1,022	1,080	6%	1,175	15%
MSCI AC World	309	320	4%	340	10%

Asset allocation weightings

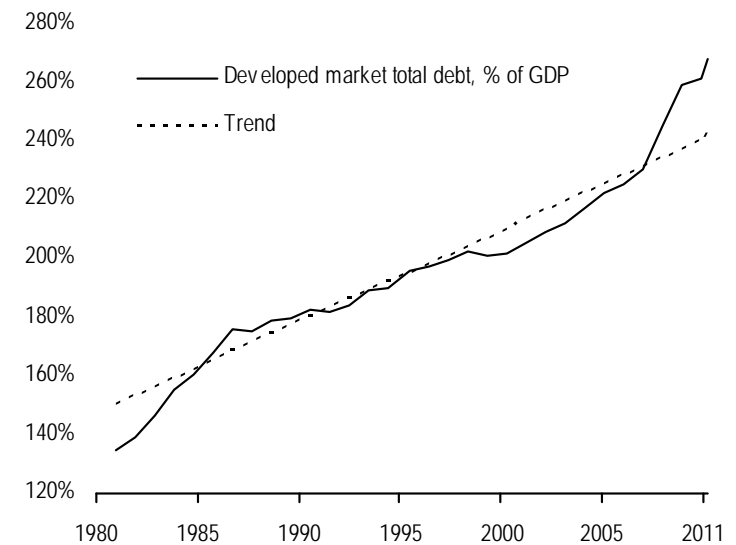
Asset class	Benchmark	Recommended weight	OW (+) UW (-)	Change
Equities	60	62	2	0
Government bonds	25	24	-1	0
Corporate bonds	5	3	-2	0
Cash	10	11	1	0
Total	100	100	0	0

The core problem is \$8trn of excess leverage in developed markets (20% of GDP).....

Public debt rising, private debt declining in the developed markets

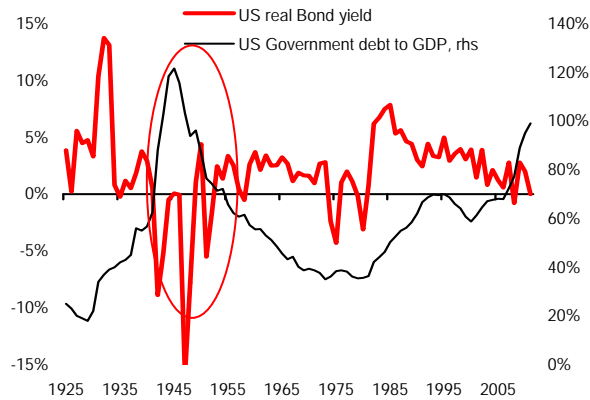


Total leverage in the developed markets is about \$8trn above trend

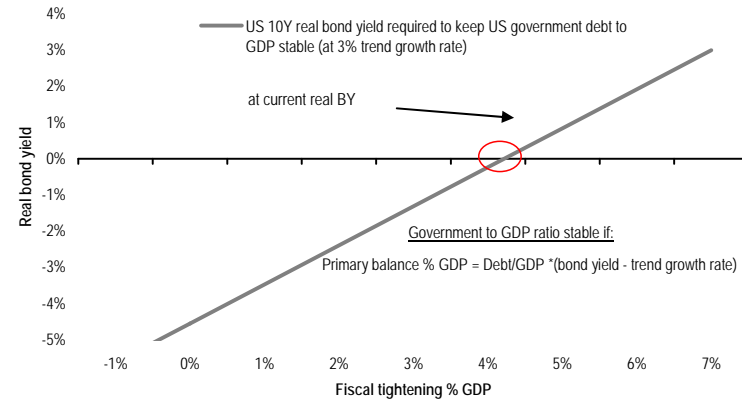


..... the solution is negative real bond yields as: a) creditors will be ripped off; b) fiscal tightening required would be more manageable; c) low rates keep savings ratio low (1% off rates, 0.4pp lower savings ratio) AND drive up GEM currencies (=force their re-leveraging)

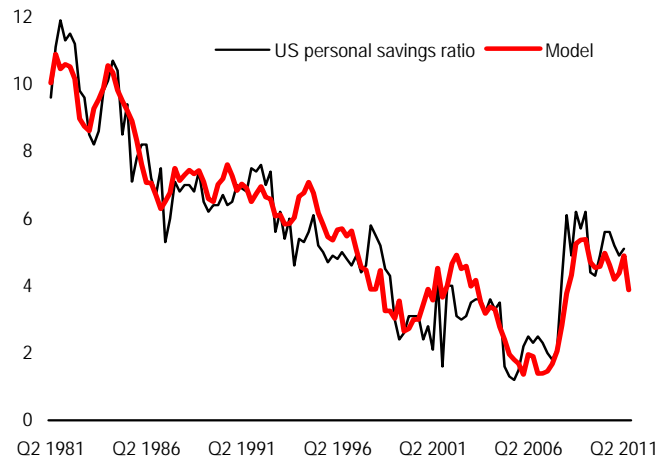
In the 1940s the Fed capped BY at 2.5% with average inflation at 6%



With the government debt to GDP ratio close to 100%, a 1pp fall in rates lower the required fiscal tightening by 1% of GDP



Our model indicates the US savings ratio can fall a bit from here



US savings ratio model details

Input Variables:	Coeff.	T-value	Current
US Net household wealth/DPI	-2.7	-13.0	5.1
US 10Y bond yield	0.4	10.2	2.3
Intercept	16.7	13.0	16.7
R2	0.90		
Standard error	0.84		
US savings ratio (model)			3.9
US savings ratio (latest)			5.4

Note:

- a 10% increase in house prices reduces the savings ratio by 0.5%
- a 10% increase in stock prices reduces the savings ratio by 0.3%
- a 1% rise in BY raises the savings ratio by 0.4%

If we adjust for GEM underleverage, the global excess debt is around \$4.5trn, 6% of global GDP. If we assume the de-leveraging lasts 5 years, the drag on global growth would be 0.6pp p.a., leaving trend growth at 4% compared to 4.6% now on IMF data

GEM can reduce the impact on global growth of the required deleveraging in the developed economies

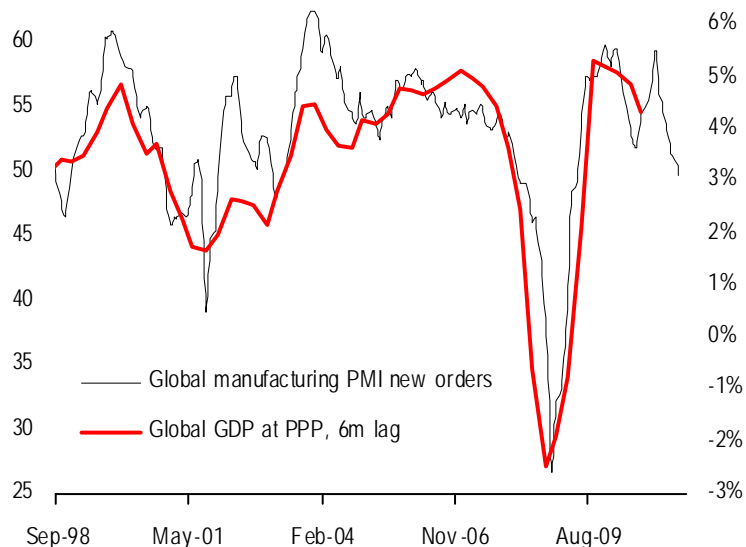
Region	Deviation from trend or appropriate level (in US\$bn)				% of global GDP
	Public debt	Private Debt	FX reserves	Total	
Emerging	-1,000	600	-3,000	-3,400	-4.4%
Developed	6,400	1,400	0	7,900	10.1%
Total	5,400	2,000	-3,000	4,500	5.8%

50% of this is China

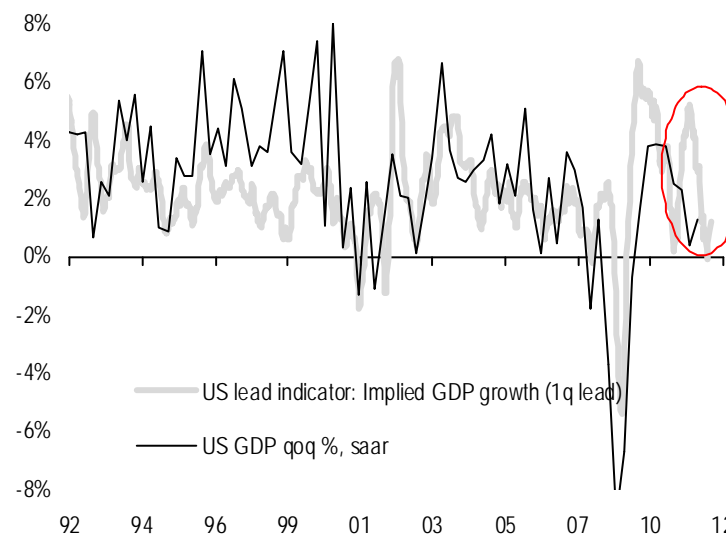
- We assume that the appropriate level of GEM public debt is 50% of GDP
- For private leverage, we look at the deviation from trend of the ratio of private debt to GDP (the trend rate of growth has been a reasonable 2% pa).
- We assume that FX reserves in GEM should be in line with the 20Y average import cover (8 months compared to 20 months now)

Core scenario (50% chance): ongoing sub-par recovery: 1.5% GDP growth in the US, 0.5% GDP growth in Europe and 8% in China - implying 3% global GDP growth this year (cf to 20-year average growth of 3.5%). The global PMI is consistent with only 3% GDP growth and our 10-factor model of US growth, which had fallen to close to 0%, is now at 1.2%.

Global PMIs are consistent with 3% GDP growth



Our US weekly lead indicators suggest GDP growth of 1.2%



Implied real GDP growth in macro variables

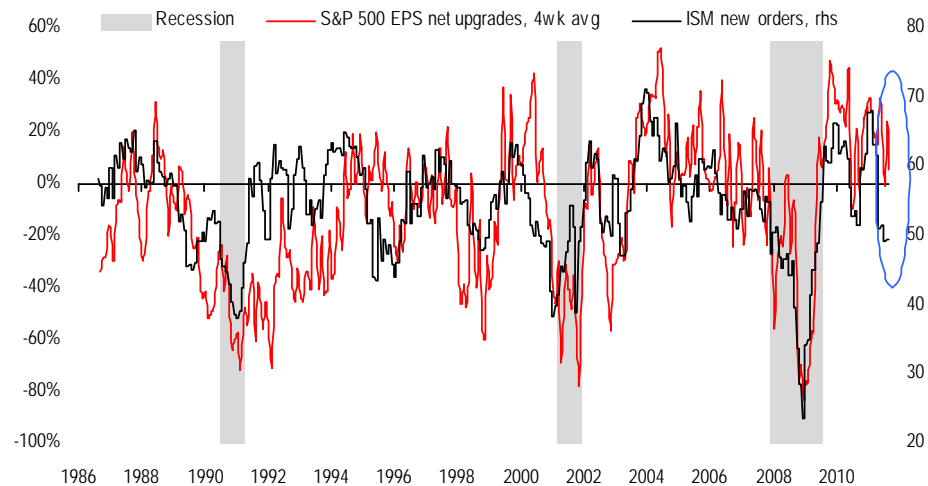
Variable	Latest value	Implied real GDP growth
S&P 500 net EPS upgrades (% tot. est.)	-0.02	2.5%
CRB industrial commodities (3m%)	-4.7	2.2%
ISM	50.6	2.2%
Jobless claims	410	1.8%
BAA Corporate spread	3.34	0.3%
ISM New orders/ Inventory	0.9	0.3%
Small Business Optimism index	98.50	0.1%
Consumer expectations (Univ. Michigan)	47.4	-0.8%
Philly Fed	-30.7	-2.0%
Average		0.7%

If all take all lead indicators together.....then GDP falls to 0.7% in US but there is a big spread!

Implied real GDP growth in macro variables

Variable	Latest value	Implied real GDP growth
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US EPS net upgrades are higher than before previous US recessions

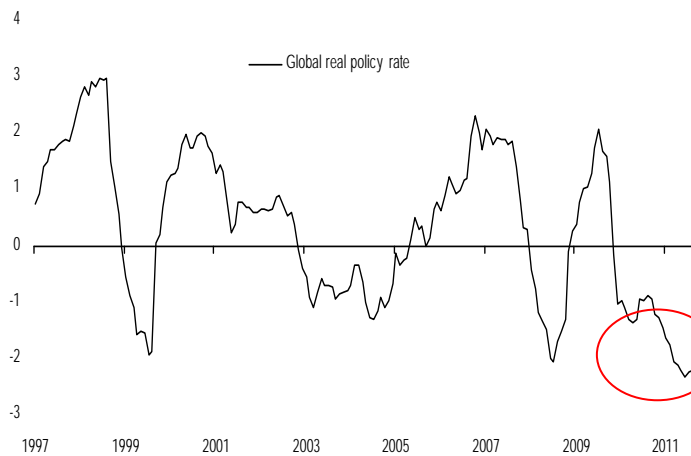


1) The normal preconditions for a recession are not in place – real rates are negative, inventories well below trend and lead indicators are still marginally positive on 6m basis. Global real rates are v loose. Cost of BBB debt and inflation expectations are well behaved

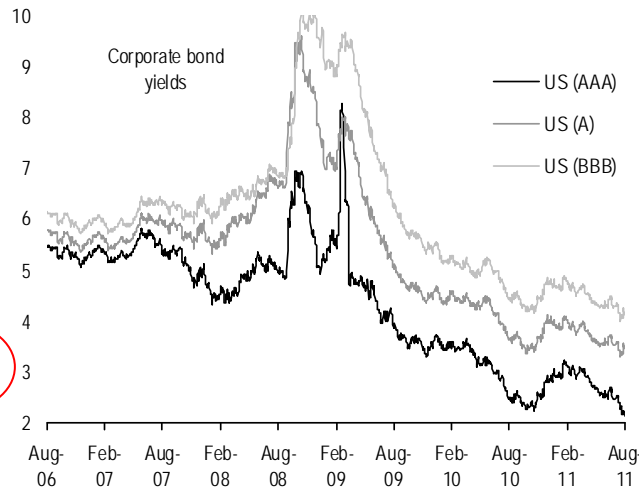
Preconditions for a US recession not in place

Variables			Average value <u>before</u> start of recession			Highest/lowest value 6 months before recession			Implied real GDP growth	
	Now	LT Average	12m	6m	0M	Value	St. dev from current	Recession start	Now	in 6 months
Real rates (3M - Core CPI)	-1.8	1.17	1.65	2.4	1.70	0.2	-1.0	Q1 1980	0.5	1.1
Yield Curve (10Y-3m)	2.1	1.51	0.22	-0.05	0.29	0.6	1.1	Q3 1990	2.6	2.6
Excess inventories (finished goods rel. to trend)	-13%	0%	3%	3%	2%	-3%	-1.4	Q3 1981	1.4	2.2
US Composite lead indicator (6m%)	1.0	1.3	1.5	-1.2	-3.0	0.0	0.3	Q3 1990	2.6	2.4
Memo: ISM index	50.9	52.9	54.3	53.2	49.3	65.8	-2.3	Q4 1973	2.4	2.5

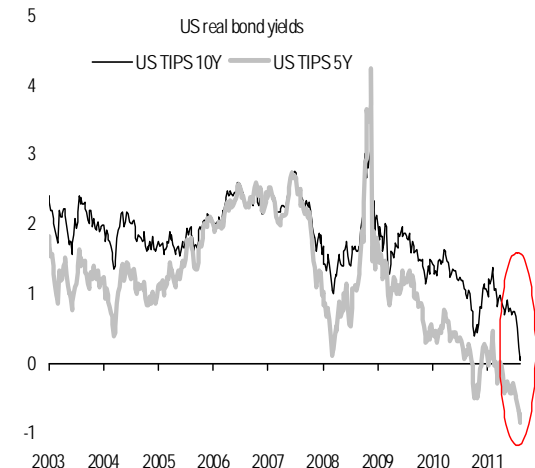
Global real rates are still at record lows



US corporate bonds yields are close to all-time lows

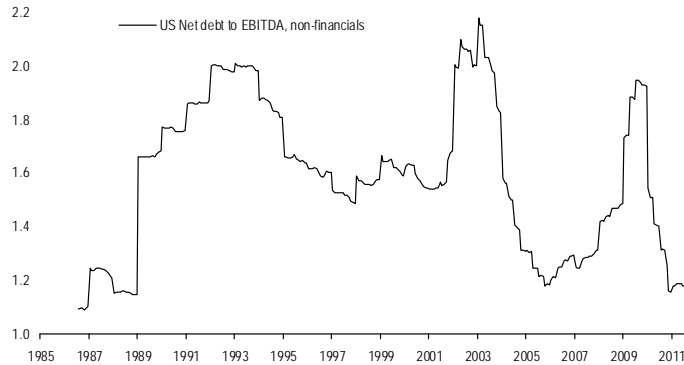


Real bonds yields are negative

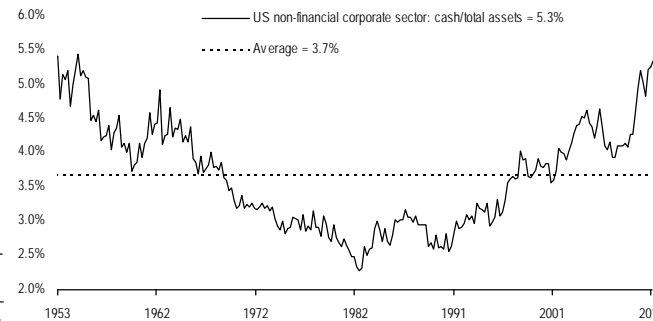


(2) The corporate sector in the developed world is still underleveraged, under-invested and has near-record FCF. In particular, investment is still 20% below previous peak while GDP is nearly back to previous peak in the US. It is possible that the end of the investment tax credit leads to a Q4 pick up in investment in the US

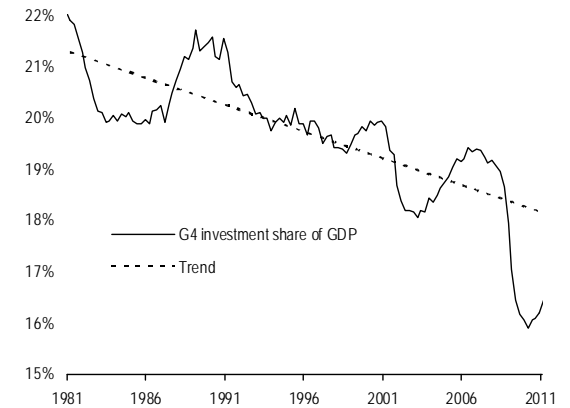
US Corporate balance sheet in good shape



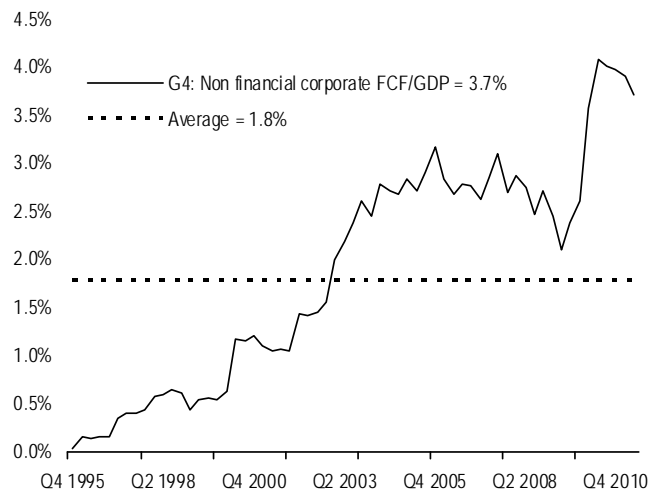
Record cash levels on the US corporate balance sheets



Developed market investment picking up but still c10% below trend



FCF as a % of GDP close to record highs



Investment has lagged GDP by 20% since 2008

Region	% from previous peak			
	Nominal GDP	Real GDP	Nominal Capex	Real capex
US	4.1%	-0.4%	-19.6%	-19.4%
Euro-area	2.0%	-1.3%	-9.4%	-12.4%
UK	3.3%	-3.9%	-17.8%	-19.4%
Japan	-10.6%	-6.0%	-17.7%	-15.4%

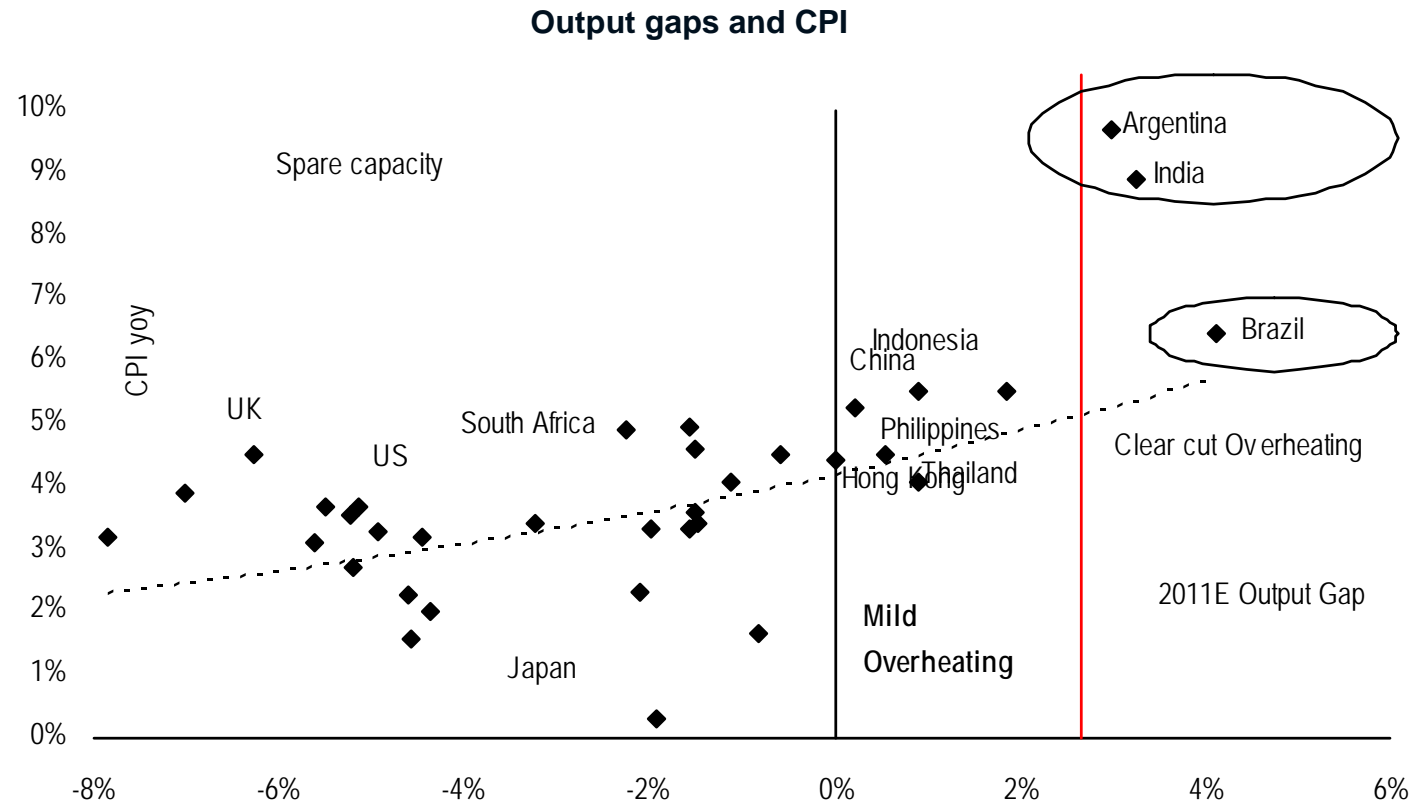
(3) No hard landing. Most important point is that GEM account for 49% of global GDP and even with 1% GDP growth in the US, 0.5% in Europe, global growth could be 3%

Even with 1% growth in the US and 0.5% in Europe, global growth can easily stay above 3% on a PPP basis

Region	share of Global GDP*	Below-par growth scenario	Growth Contribution	Potential growth
US	19%	1.0%	7%	2.7%
Euro area	14%	0.5%	2%	1.7%
UK	3%	0.5%	0%	2.6%
Japan	6%	1.0%	2%	1.2%
Other developed	9%	0.8%	2%	2.0%
China	14%	8.0%	39%	9.5%
India	6%	6.0%	11%	8.1%
Other NJA	8%	4.0%	11%	5.5%
Brazil	3%	3.0%	3%	4.2%
Other Latam	6%	3.0%	6%	4.0%
Russia	3%	4.0%	4%	4.0%
Other EMEA	10%	4.0%	13%	5.2%
Global	100%	3.0%	100%	4.7%
Emerging	49%	5.2%	86%	6.7%
Developed	51%	0.8%	14%	2.4%

* IMF - at PPP exchange rates

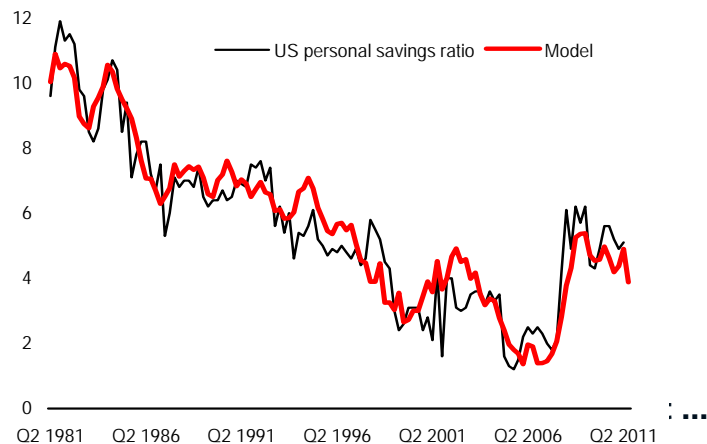
Yes, there is overheating in GEM (in other words negative output gaps)is modest in China and only severe in India and Brazil where GDP growth of 6% (cf consensus 7.5%) and 2.5% (cf 3.5% consensus) is required, respectively, to resolve overheating.



	Output gap	Trend GDP growth	GDP growth (CS estimates)		Implied output gap end-2012
			2011	2012	
India	3.2	7.4	7.5	7.5	4.0
Brazil	4.1	3.7	2.9	4.0	3.9

(4)The US savings ratio is likely to fall slightly as a low bond yield drives down the savings ratio as the top income quintile account for 40% of consumption and in turn have a saving ratio of 20%. Assuming half of the fall implied in the model and a modest employment growth in line with our models, we get a c1% consumption growth (the Japanese saving ratio fell from 15% in 1990 to 1% in 2009).

Our model indicates the US savings ratio can fall a bit from here



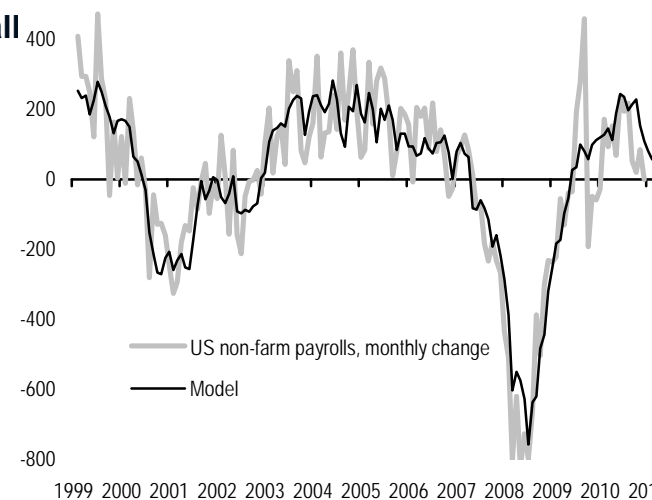
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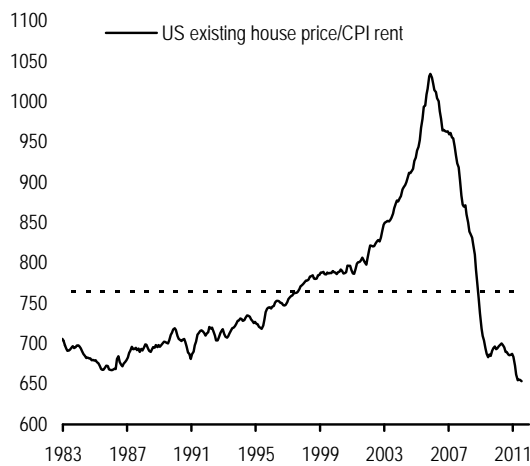
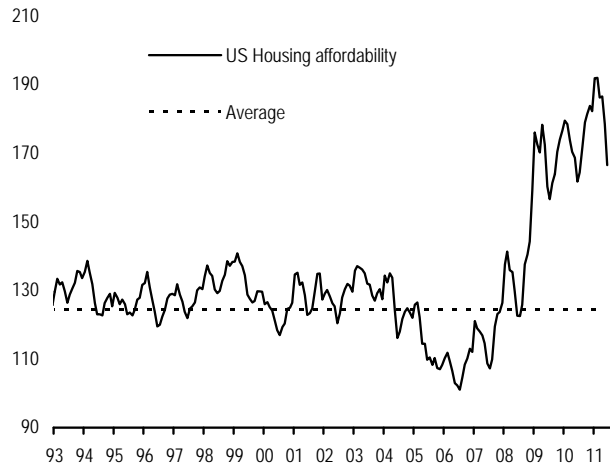
Our US employment model suggest a small increase in employment

Model of monthly change in US non-farm payrolls			
Input variables (3m lead)	Coefficient	Last	Standardized
Temporary employment, 3m change	0.4	-30.5	-0.4
Consumer employment exp.	5.0	-10.8	-0.7
Jobless claims (4-w average)	-0.3	410	-0.3
Job-cuts announcements	-0.1	51.1	0.8
ISM employment, composite (no lead)	26.1	52.2	0.5
Intercept	-1159	Model estimate	% rise in empl.
R2	0.80	28	0.3%

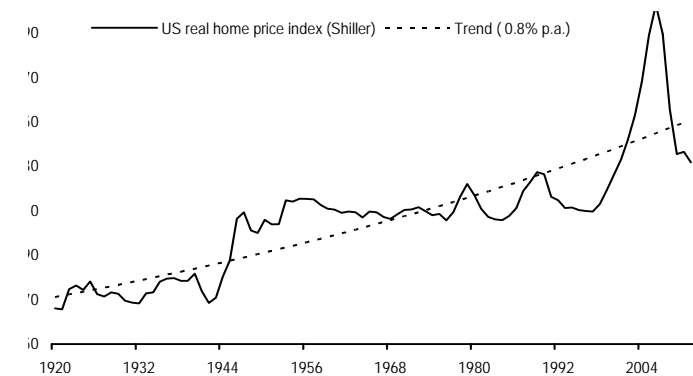


(5) We find US housing affordability extremely attractive on all measures. If we look at shadow and actual inventories there is about 2X years of excess inventory (the issue is that only 40-50% of foreclosed homes become vacant). If house prices do fall 5% (as our housing analysts forecasts), then Non Performing Assets only increase by 4% . The NAHB has stopped falling, the vacancy rate and real house prices are now below trend

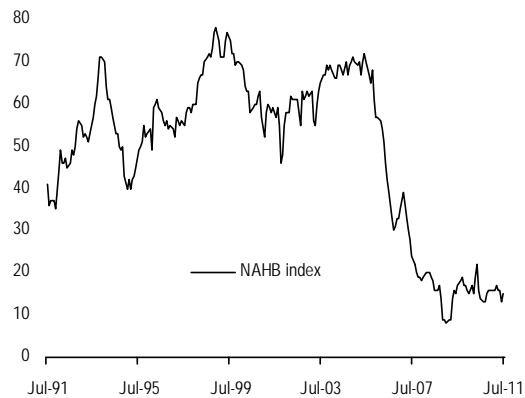
US housing affordability extremely high ... and relative to rents, US housing is the cheapest on record



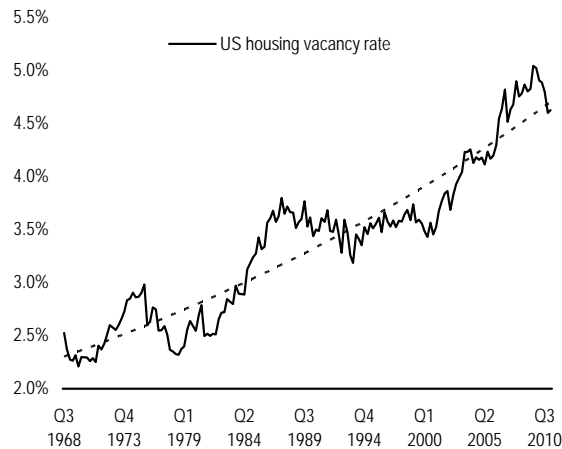
US real home prices are now below 15% long-term trend



NAHB index is forming a low



US vacancy rate below trend



US excess housing inventory is about 2 years of sales

Estimate of US housing demand (million units)	
Household formation	1.31
+ Trend growth of vacant units	0.05
+ Net Removal of housing units	0.26
= Underlying demand of housing units	1.62
- Placements of mobile homes	0.14
= Total underlying demand for housing units	1.48
+ Units started but not completed	0.06
= Underlying numbers of housing starts	1.54
- Current level of housing starts	0.60
= Net demand (a)	0.94
Net supply from unsold homes	0.93
+ Net supply from foreclosed properties*	0.99
= Excess housing inventory (b)	1.9
Years required to absorb excess inventory (b/a)	2.0

*50% of housing units in foreclosure process

The biggest risks: 1) FISCAL tightening next year 2.5% (=all scheduled, 1.8% if payroll tax credits are renewed), 1.5% of GDP in Europe. Our core scenario calls for watered down fiscal tightening in the US (payroll tax credit being renewed) with a multiplier of 0.5X which is normally the case...hence fiscal tightening takes 0.9% off US GDP

Major fiscal adjustments in the OECD countries over the last 30 years

Country	Trough in govt. deficit* % GDP		Peak in govt. surplus* % GDP		Fiscal Adjustment			Expenditure cuts, % tot.	GDP growth p.a (around deficit trough)		Change in REER
	Date	Level	Date	Level	Duration (yrs)	% change	% p.a		5Y before	5Y after	
Ireland	1980	-7.2	1989	4.8	9	12%	1.3%	79%	3.2	1.7	12%
Belgium	1981	-8.0	1987	3.1	6	11%	1.8%	63%		1.4	-7.3%
Denmark	1982	-6.3	1987	6.3	5	13%	2.4%	0%		3.2	11.1%
Australia	1985	-13.6	1989	2.1	4	16%	3.7%	110%	3.2	3.3	-12.9%
Canada	1985	-5.4	1997	5.7	12	11%	0.9%	88%	2.8	2.9	-17.0%
Greece	1989	-6.3	1994	4.4	5	11%	2.0%	-50%	1.8	0.8	11.7%
Italy	1990	-2.5	1997	6.6	7	9%	1.3%	25%	3.3	1.1	-13.2%
Sweden	1992	-5.7	2000	4.9	8	11%	1.3%	142%	2.6	1.2	-22.8%
Finland	1993	-3.8	2000	7.2	7	11%	1.5%	94%	3.4	3.3	-18.0%
UK	1993	-4.2	2000	3.3	7	8%	1.1%	52%	3.9	3.4	6.4%
Average/Median		-6.3		4.8	7.0	11%	1.7%	71%	3.0	2.2	-5.0%
IMF estimates											
Greece	2009	-10.3	2015	7.7	6	18%	2.8%	44%	4.4		-
Ireland	2008	-10.4	2014	3.1	6	14%	2.1%	45%	5.3		
Portugal	2009	-7.2	2015	3.2	6	10%	1.7%	67%	1.0		
Spain	2009	-8.5	2015	-0.6	6	8%	1.3%	56%	3.5		-
Average/Median		-9.1		3.4	6.0	12%	2.0%	53%	3.5		

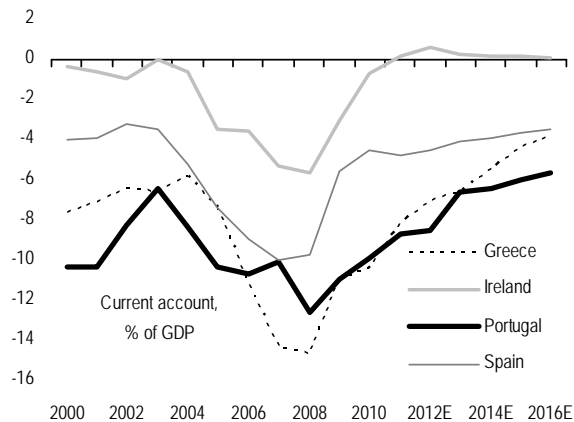
* Cyclically-adjusted primary balance, % of GDP

Historically, periods of significant fiscal tightening in OECD countries (i.e. an increase of the cyclically-adjusted fiscal balance as a proportion of GDP above 7pp) has been associated with a manageable 0.8pp lower growth rate in the five years after the fiscal tightening began compared with the five years before

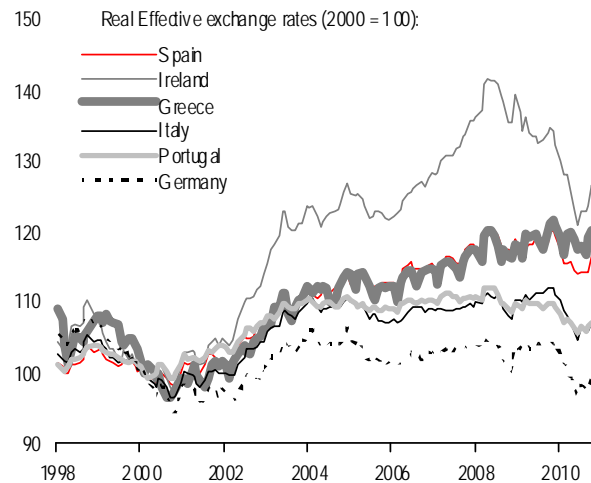
■ Multiplier=0.8/1.7

2) Peripheral Europe: the bad news....We think that Portugal, Greece and Spain need more deflation as there has never been a banking crisis without countries ending up on either a current account surplus or an undervalued currencies. We estimate that a fall in wages of between 8% and 15% is needed in Greece, Portugal, and Spain over the next 5 years. Only in Portugal is 2012 consensus growth negative. During previous sovereign debt crises REER fell by c50%, compared to only 2.4% in Greece so far.

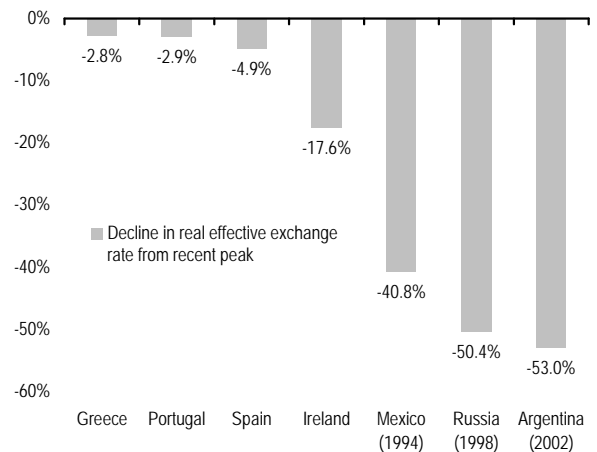
Peripheral European countries still run current account deficits...



... and have overvalued real effective exchange rates



In previous sovereign crisis REER fell much more- by c50%

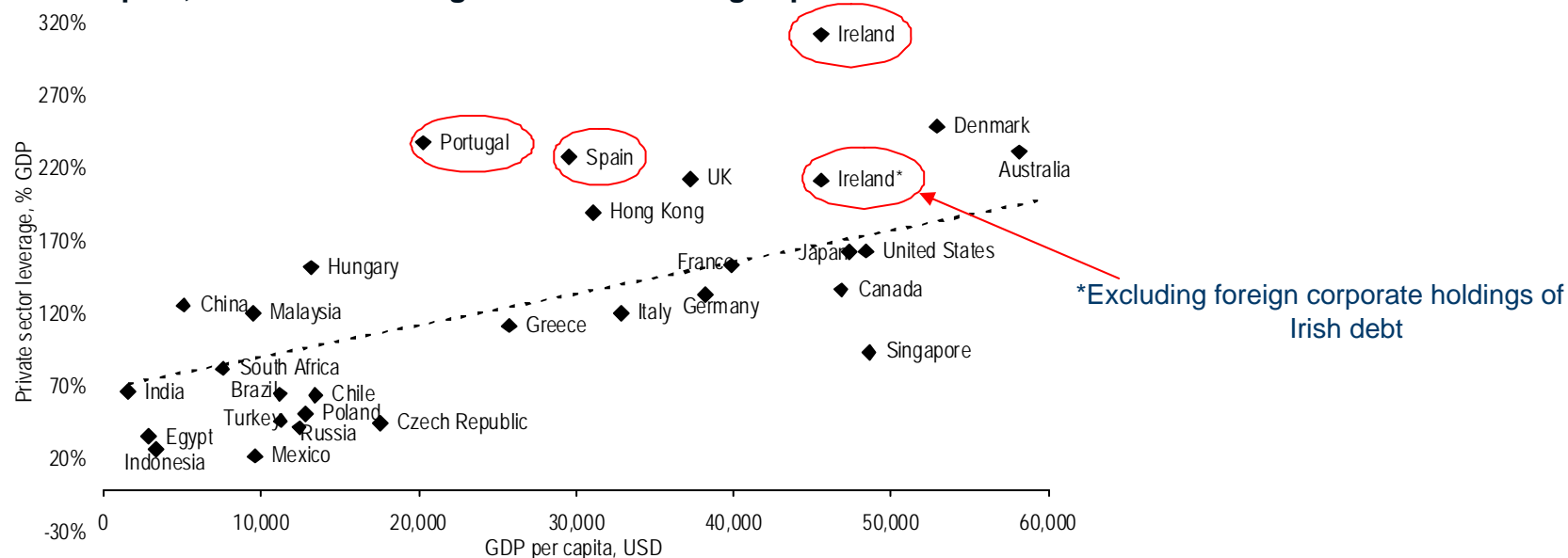


Outright deflation required in peripheral Europe to restore competitiveness...

Country	Optimistic scenario		Central scenario		Nominal GDP growth	
	Wage level, % change over next 5Y	Wage growth p.a. over next 5Y	Wage level, % change over next 5Y	Wage growth p.a. over next 5Y	2012e Consensus	2011-5E IMF estimates
Greece	-9%	-1.8%	-15%	-3.3%	0.8%	1.9%
Italy	-5%	-1.0%	-12%	-2.5%	3.5%	3.4%
Spain	-5%	-0.9%	-11%	-2.4%	2.8%	3.3%
Portugal	-2%	-0.4%	-9%	-1.8%	-0.6%	1.8%
Ireland	-1%	-0.2%	-8%	-1.6%	2.1%	3.2%
Germany	12%	2.3%	9%	1.8%	3.9%	3.0%

The degree of deleveraging of the private sector is huge and this has hardly started (since peak private sector leverage is down by 20% in Ireland, only 2% in Greece, while private sector debt in Portugal and Spain has not fallen at all)

Spain, Ireland and Portugal have overleveraged private sectors



In previous major banking crisis, total debt levels fell on average by a third in 4-5 years

Deleveraging has been limited so far

Country	Peak leverage		Deleveraging	
	Date	Private sector debt to GDP	Peak-to-trough change in debt levels	Duration (m)
Argentina	Feb-99	24%	-43%	60
Mexico	Apr-95	35%	-16%	20
Sweden	Nov-90	56%	-26%	62
Thailand	Jan-98	170%	-40%	48
Average		71%	-31%	47
Median		46%	-33%	54

Country	Date	Peak leverage		Deleveraging			
		€, bn	% of GDP	Implied	So far	Still required	
		€	% of GDP	€, bn	% of GDP	% of GDP	% of GDP
Spain	Jun-10	2,413	228%	750	71%	1.4%	69%
Portugal	Sep-10	402	235%	125	73%	1.1%	72%
Ireland	Dec-09	526	329%	163	105%	9.8%	95%
Greece	Jun-10	267	115%	83	32%	1.7%	30%
Total				1,122	68%	2.2%	66%

... Some form of restructuring in Greece and Ireland (c30% haircut) is unavoidable in our view. We think Ireland and Greece will end up with government debt-to-GDP of around 147% and 144% of GDP by 2014. Spain, with government debt-to-GDP at 99%, just survives. Market implied write-offs of debt are realistic in Greece ...to get government debt back to 100% of GDP a 30% write-off is required in Greece and 68% is priced in! In Ireland 36% priced in!

Market implied write-offs are now realistic

Country	Government debt to GDP			% haircut required to reduce government debt/GDP to 100%	Implied haircut in 5Y CDS	Fiscal tightening required to stabilize government debt to GDP using:		Estimated fiscal tightening 2011-14
	2010E	2014E	2014E (incl. de-leveraging, debt swap/buyback)			Current bond yield	EFSF rate (3.5%)	
Ireland	96%	125%	145%	31%	36%	19.7%	7.1%	8.0%
Spain	60%	72%	98%	-2%	18%	9.3%	7.1%	4.2%
Portugal	83%	101%	132%	24%	42%	15.1%	4.3%	5.1%
Greece	142%	160%	144%	30%	68%	22.9%	4.5%	9.3%
Italy	118%	119%	119%	16%	18%	2.1%	-0.1%	3.2%

After accounting for announced debt swap/buyback

Required fiscal tightening to stabilize government debt-to-GDP

The cost of bailing out the euro (we assume this is the cost of bringing down peripheral government debt to 100% by 2014) is much less than the direct cost of not bailing out the Euro (we assume a 40% haircut on core European banks exposure to peripheral Europe and the same haircut on direct and indirect- via repo- exposure of the ECB to the periphery)

First round cost of not bailing out peripheral Europe

(assuming the decision not to bail-out leads to a 40% haircut on all peripheral European assets)

Core banks' exposure to peripheral Europe	<u>690</u>
ECB repo exposure to peripheral Europe	<u>308</u>
ECB direct holdings of peripheral European government debt	111
Core Europe total exposure	1,109
Loss assuming 40% haircut	443

Overall costs would likely be considerably higher, once second-round and third-round implications are taken into account (appreciation of the new DM, trade tensions etc)

Cost of bailing out peripheral Europe

(The cost of bringing down government debt levels to 100% by 2014, taking into account of government deficits up to that point as well as the projected burden placed on public finances by the required private-sector deleveraging)

	2014E government debt to GDP	GDP	Required bail-out cost
Ireland	<u>147%</u>	155	73
Spain	<u>99%</u>	1,085	na
Portugal	<u>134%</u>	173	59
Greece	<u>155%</u>	227	125
Total			257

What is the end game?

- Buy in government peripheral debt (at close to current market prices) and then cancel it – this could happen if Greece uses EFSF funds to buyback its own debt (mechanism: EFSF lends money national govt to buy in its debt).
- Issue a Eurobond with conditions attached (and if a country broke these conditions then it is kicked out of Euro!) – this solves the credit risk problem of the periphery and create a huge debt market – pushing down the liquidity premium
- The size and quality of the ECB balance sheet deteriorates - a sort of fiscal transfer as the ECB has to be recapitalized at some point= weaker Euro longer term. The ECB owns €111bn of peripheral European debt - the more it buys, the more it is in its interests to keep buying (China is in a similar situation with its dollar FX reserves).
- A depression in peripheral Europe (under all circumstances)

Equities in our core scenario (1,350 S&P 500, 50% probability)

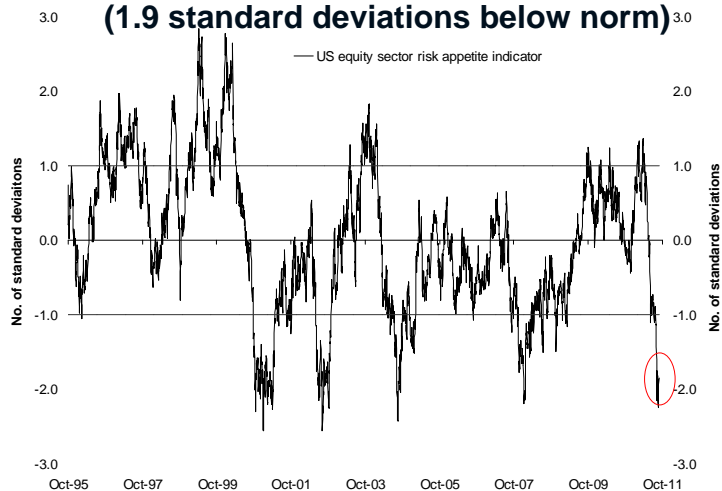
- **Tactical:** Risk appetite been hovering 2.5-3 std below norms, while buybacks and net corporate buying have been rising strongly. Try and find a bull!
- **Valuation:** ERP is 7.4% on operating earnings (should be 6.2%, given ISM and credit spreads cf to long run norm of 4.2%). Yet, corporate balance sheets are, in aggregate, safer than governments (that's unusual)
- **Inflation expectations are stable** (2.5%), markets de-rate if inflation expectations fall below 1% or rise above 4%. Unlike 2008, BBB and index linked bond yields have been falling.
- **EPS:** lower break-even (as 46% of earnings in US from outside US). 1%-1.5% GDP growth is the new breakeven. GDP was 1% 1H, yet EPS grew 12% yoy. Margins peak when wage growth is 3.5% (cf 2% now). Scope to increase EPS by 10% through leverage.
- **Economic indicators** (initial jobless claim, consumer confidence and ISM) suggest S&P 1250
- **Equities are underowned**
- Was Japan that bad? P/E 15X, dollar returns of 15%, GDP pc 1% since 1990.
- **Negative:** margins are very high. Thus on 'normalised' measures fair value is around 1,090 on S&P 500- but this only means that at 1090 *real* returns will be in line with average (6%), while current levels should give circa 5% real.

The main investment implications under our core scenario

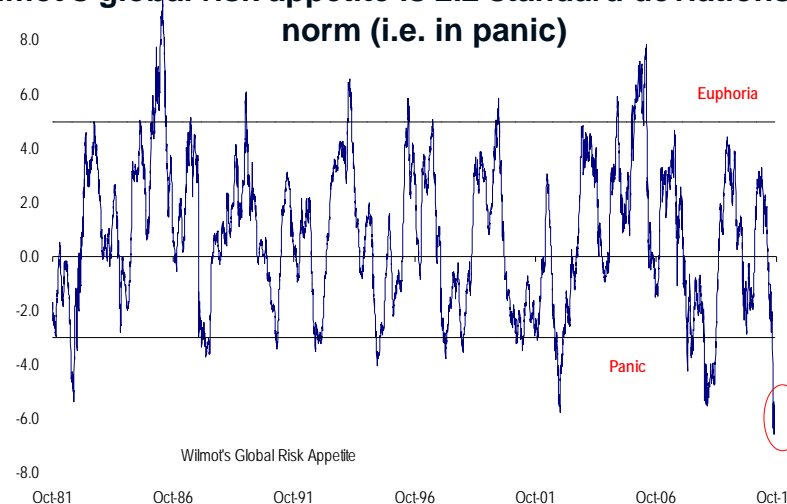
- **The fair value of the S&P is c1,350**
- **Europe continues to underperform**
- **Markets can and, we think, will be led higher by defensive sectors** (consumer staples can lead a bull market, as they did between 1984 and 1987).
- **Our themes of quality growth and pricing power continue to be re-rated**, as low real rates benefit long-duration assets
- **The GEM consumer remains the main driver of global growth. In consequence, GEM consumer plays continue to re-rate**
- **We continue to buy regulated utilities with a CPI link**, which we regard as index-linked bond proxies (we like SSE and UU), **as well as UK property companies** (given that we expect the 10-year index-linked gilt yields to fall to minus 1%, and possibly even lower).
- **In aggregate we stay underweight cyclicals** (European capital goods, hotels and retailing). **Our preferred cyclical areas are software and luxury goods. Overweight telecoms.**
- **Banks:** we think that banks should trade at a 20% to 30% discount to fair-value before to warrant a neutral (circa 0.65X tangible book, compared to 0.7x now).

Core scenario: Equities: short term: both equity sector risk appetite and Wilmot's global risk appetite are depressed. On previous occasions when these risk appetite measures fell to current levels, equities did ok in the short-term

US equity sector risk appetite is very depressed (1.9 standard deviations below norm)



Wilmot's global risk appetite is 2.2 standard deviations below norm (i.e. in panic)



S&P 500 price performance after the US equity sector risk appetite fell to current levels

Date	S&P performance after						
	1w	2w	1m	2m	3m	6m	12m
10-Apr-01	2.0%	3.5%	7.4%	8.3%	1.0%	-7.5%	-3.2%
11-Oct-02	5.9%	7.5%	7.1%	8.3%	11.0%	3.9%	24.3%
09-Sep-04	0.5%	-0.9%	0.3%	4.1%	6.2%	7.3%	11.0%
22-Jan-08	4.0%	2.0%	2.4%	1.5%	5.3%	-2.2%	-35.9%
Average	3.1%	3.0%	4.3%	5.5%	5.9%	0.4%	-1.0%
Median	3.0%	2.8%	4.8%	6.2%	5.8%	0.9%	3.9%
% rise	100.0%	75.0%	100.0%	100.0%	100.0%	50.0%	50.0%

S&P 500 price performance after Wilmot's global risk appetite fell to current levels

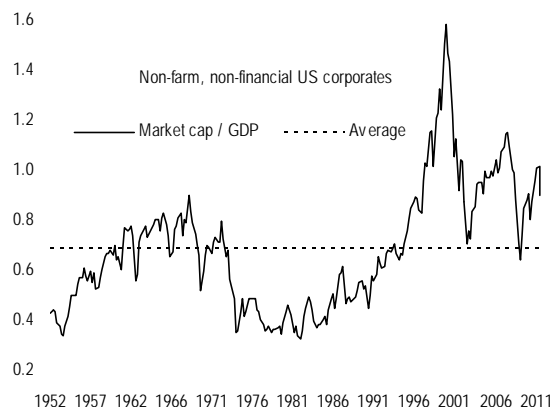
Date	S&P performance after						
	1w	2w	1m	2m	3m	6m	12m
11-Oct-02	5.9%	7.5%	7.1%	8.3%	11.0%	3.9%	24.3%
24-Nov-08	-4.2%	6.8%	1.9%	-2.3%	-9.2%	6.9%	29.8%
Average	0.8%	7.1%	4.5%	3.0%	0.9%	5.4%	27.0%
Median	0.8%	7.1%	4.5%	3.0%	0.9%	5.4%	27.0%
% rise	50.0%	100.0%	100.0%	50.0%	50.0%	100.0%	100.0%

Core scenario longer term: long-term valuation measures (Tobin q, P/E on trend earnings, market cap-to-GDP and real equity prices) imply a fair value of 1,090 on the S&P 500. However, this 10% overvaluation implies equities are going to yield a real rate of return over the long-term that is 10% lower than the historic norm (i.e. 5.7% not 6%). This though compares to an index linked bond yield that is negative.

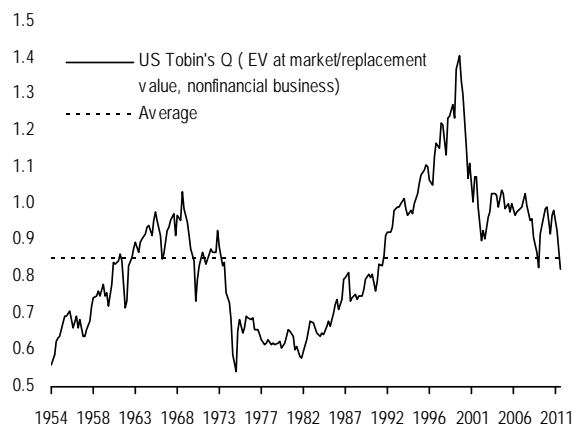
Long-run equity valuations

Valuation indicator	Current level		S&P value if indicators were at long term levels
	Value	St.dev. from avg/trend	
Tobin's Q (EV/replacement value)	0.82	-0.17	1,205
Market Cap to GDP	0.90	0.85	891
Price to trend EPS	16.9	0.21	1,071
Wilmot LR returns	10.4	-0.77	1,191
Average		0.0	1,089

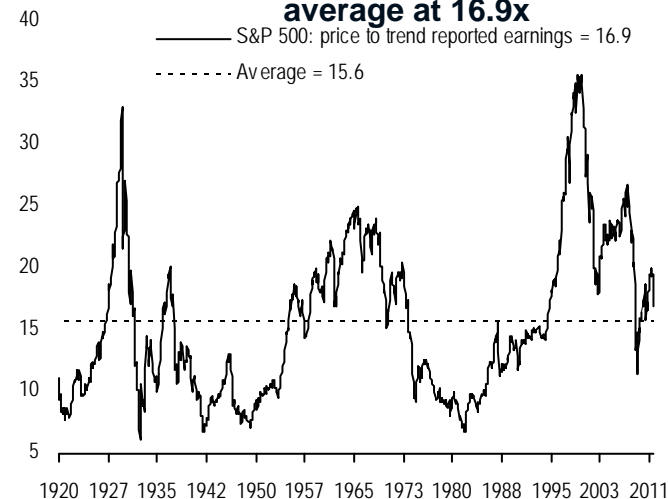
Market cap-to-GDP ratio



Tobin's Q



US cycle-adjusted P/E is above average at 16.9x



Valuation: If we put our below-consensus EPS number into our ERP model, the corresponding ERP is 7.4%, against a warranted ERP of 6.2% (the warranted ERP is based on credit spreads and ISM), i.e. equities would have c20% upside. The market is pricing in an EPS number of \$77 (at this level the ERP would be equal to the warranted ERP but critically this assumes that ISM and credit spreads stay at current levels). This would imply an 18% decline in EPS from current levels and would leave EPS numbers 29% below 12 month forward IBES numbers. The long term equity risk premium has been 4.2% (110 year average). (all estimates based on operating not reported, reported numbers would be 15% lower)

The actual US equity risk premium is 7.4% (all based on operating EPS)

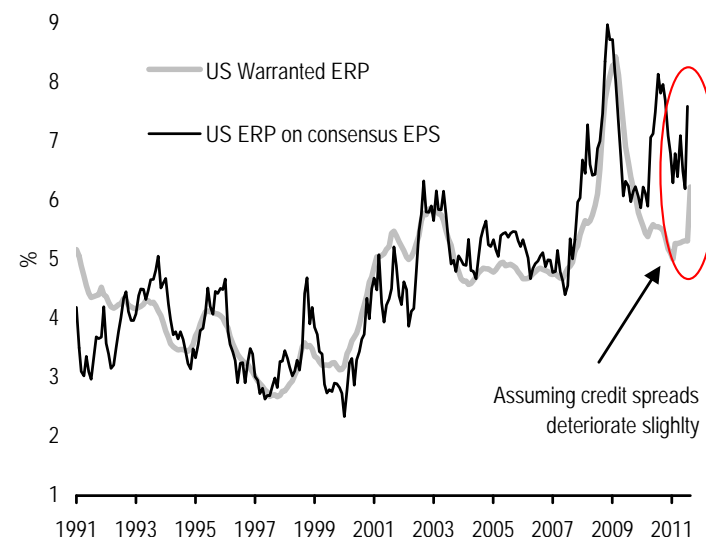
US ERP	12mth fwd EPS	12-24mth fwd EPS growth	3-5yr fwd EPS growth	Equity risk premium
on 12m forward consensus EPS estimates	\$107.9	12.6%	11.5%	9.5%
on consensus EPS estimates, assuming historic long-term EPS growth	\$107.9	12.6%	6.4%	7.9%
on our EPS forecasts	\$99	12.6%	6.4%	7.4%
on trend operating EPS of \$81	\$81	6.4%	6.4%	6.4%
Historical 110- year average equity risk premium				4.2%

The historical average risk premium is based on reported earnings

Our model suggest a “warranted” ERP of 6.2% under the assumption that credit spreads deteriorate a bit

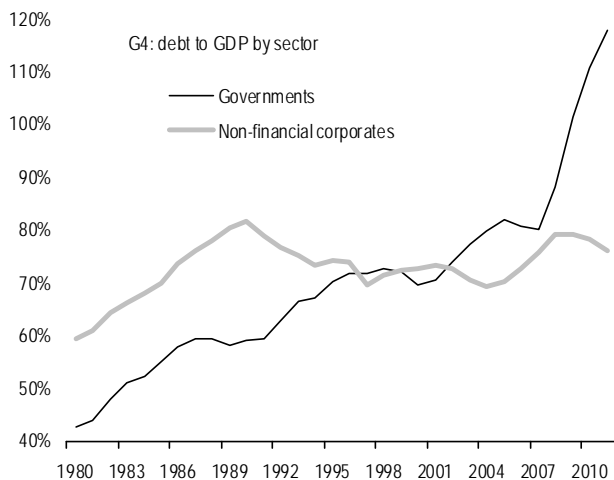
Model inputs	Coeff.	t-value	Current	Scenario
US lead indicator - dev. from trend	-0.17	-18.1	-6.2	-7.7
BAA Corp. bond spread	0.27	4.4	3.3	3.8
Model output				
US warranted ERP (consensus, operating)			5.8	6.2
US warranted ERP (reported EPS)			4.7	5.0
Current ERP			7.9	
Long-term Average			3.6	
RSQ	0.78			
St. error of estimate	0.48			
Intercept	3.9			

Our “warranted” ERP has a good fit with the “implied” ERP



Government finances have deteriorated relative to that of corporates. 16% of US market cap now has a CDS spread below that of the government, 16% in the UK, 17% in Japan and 36% in France (!)

Corporate balance sheets in the G4 economies (US, UK, Germany & Japan) are in a better state than government balance sheets



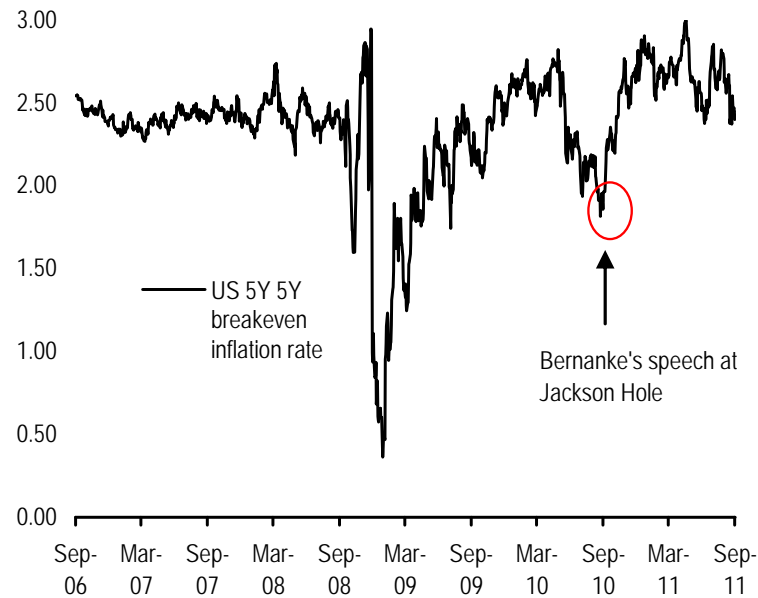
16% of US market cap has a CDS spread below that of the government, 16% in the UK, 17% in Japan and 36% in France

Country	Sovereign CDS*	CDS lower than sovereign	
		# of cos	M Cap
USA	47	4.5%	16%
Japan	55	17%	17%
UK	79	8.0%	16%
France	126	20%	36%
Germany	57	0%	0%

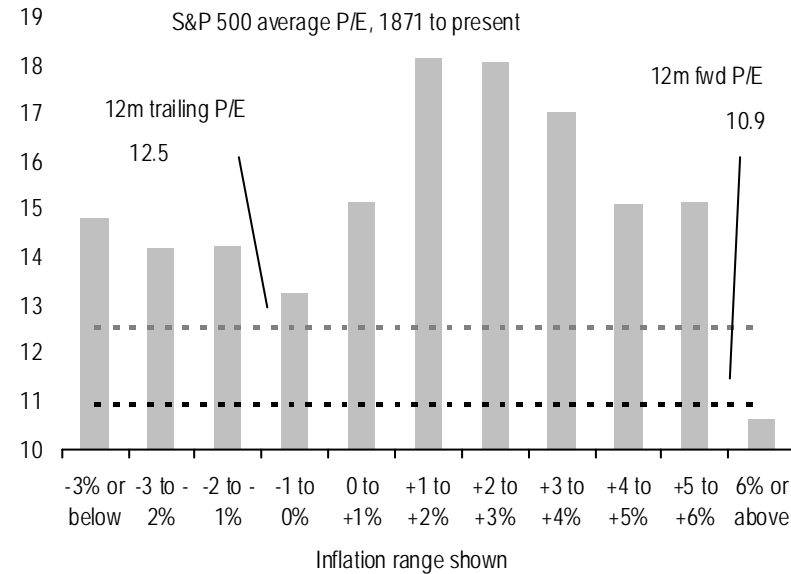
**Euro debt for USA, USD debt for other*

Equities represent a hedge against inflation until inflation expectations rise above 4% (they then typically de-rate aggressively just as they de-rate aggressively when inflation expectations fall below 1%)

5-year/5-year inflation expectations stand at 2.4%

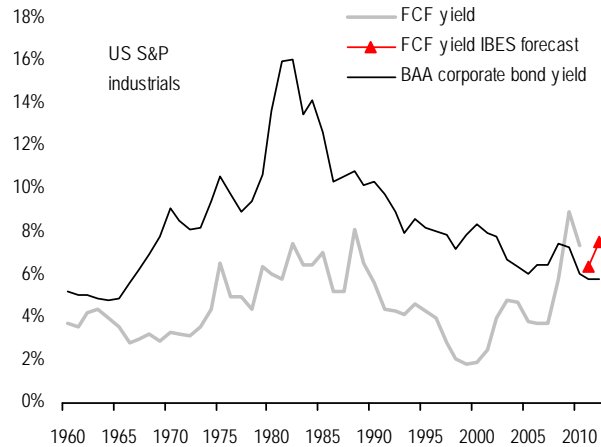


Equities do not tend to de-rate significantly unless inflation rises above 4%

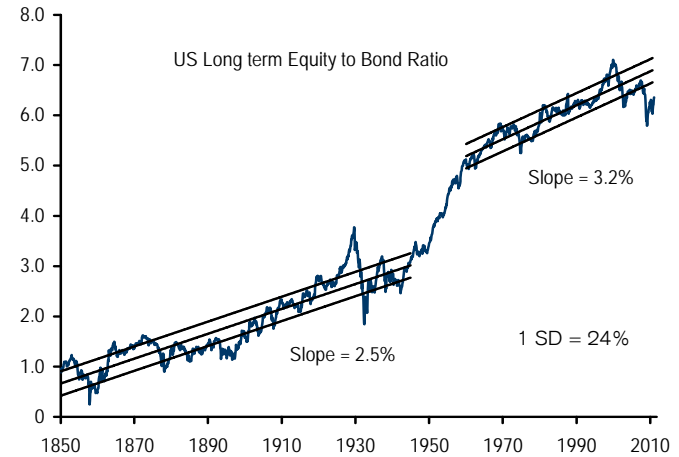


Valuation of equities is clearly cheap against bonds (FCF yield v BAA corporate bond yield) is at an all-time high. Equities are cheaper against index-linked bonds than even in 2009. The ratio of equity to bond returns is still close to a 24-year low

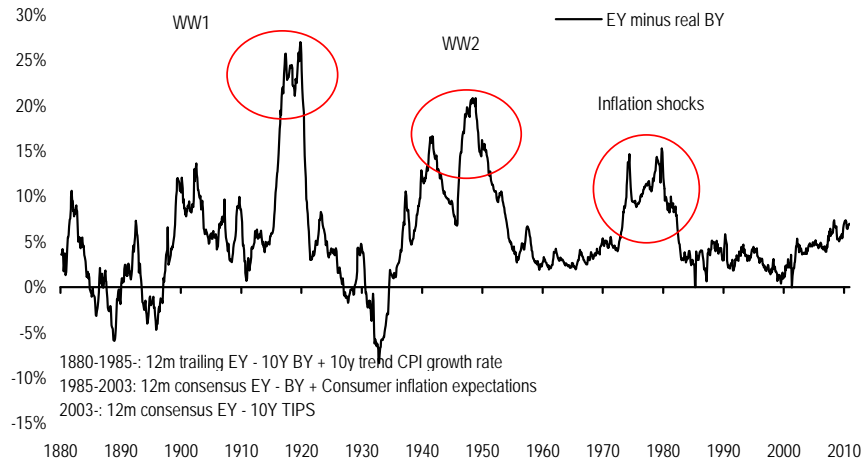
The FCF yield is above the corporate bond yield



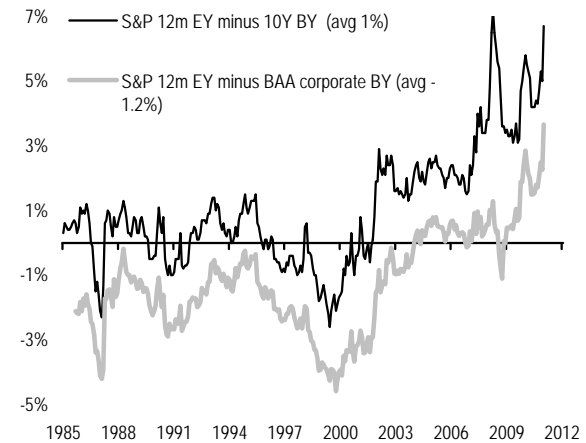
Equity to bond returns is abnormally low ...



The US earnings yield is 7pp higher than the real BY



EY vs BY and BAA corp BY



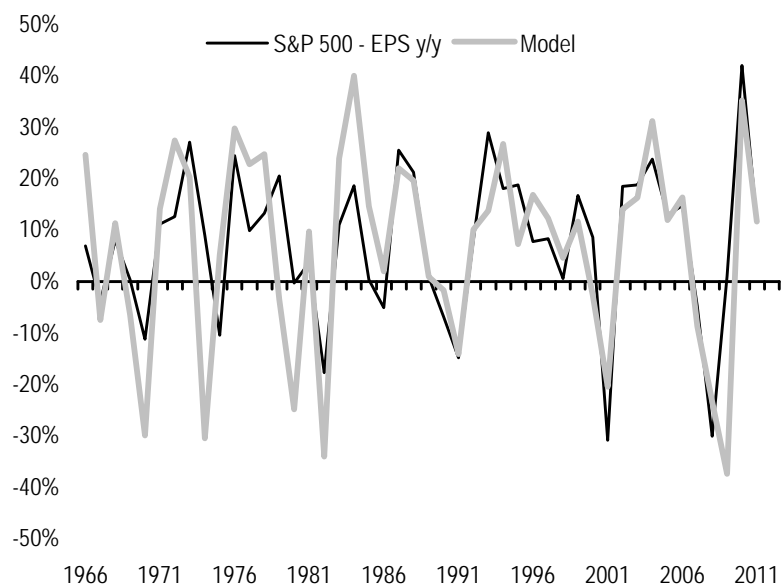
Earnings. Using new GDP numbers, our EPS numbers are well below consensus but positive (2012 we are 13% below consensus, \$99 v \$112) ...

Our forecasts are well below consensus

Region	Real GDP growth - consensus		Real GDP growth - our forecast	
	2H	2012	2H	2012
US	2.3%	2.5%	1.5-2%	2.1%
Euro-area	1.5%	1.6%	0-0.5%	1.0%

Region	EPS growth - consensus		EPS growth - our forecast	
	2011	2012	2011	2012
US	17%	15%	12%	6%
Euro-area	5%	14%	4%	6%

Our US profit model suggests EPS growth of 6% next year



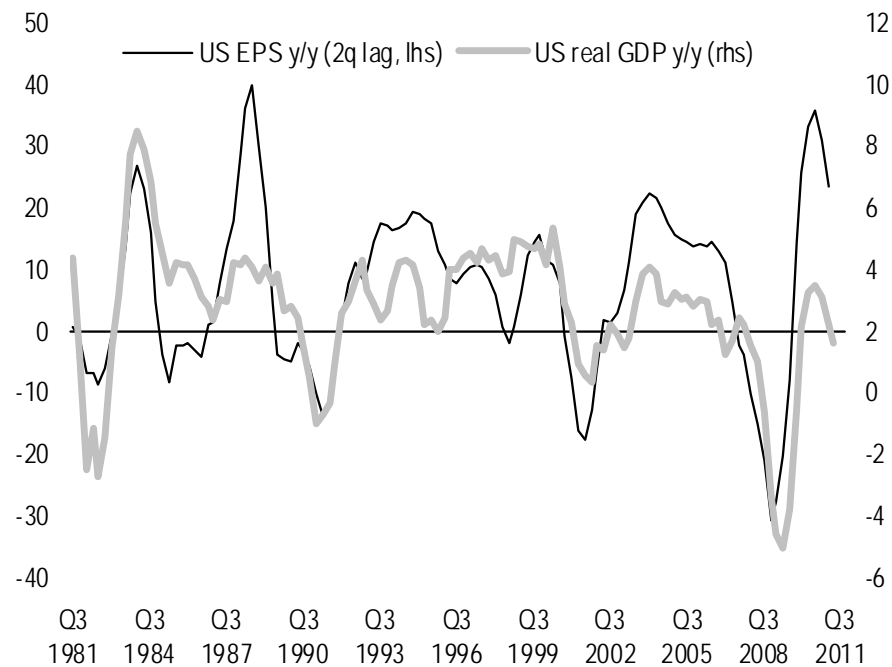
Model inputs, % chg	Coefficient	2010E	2011E	2012E
US Real GDP (adj. for foreign exp.)	5.8	3.5%	1.8%	2.0%
Non-fin. corporate GDP deflator	6.8	1.0%	1.2%	1.5%
Total costs (ULC+NULC)*	-6.4	-3.5%	0.9%	1.0%
USD trade-weighted	-0.4	-7.0%	-9.0%	-5.0%

*ULC= Unit labour costs, NULC (nonlabor unit costs = 50% depr./10% interest/ 40% taxes)

Model output				
S&P 500 - operating EPS, yoy		41%	12%	6%
S&P 500 - operating EPS (level)		\$83.8	\$93.5	\$99.3
Consensus estimates		\$83.8	\$98.0	\$112.2
RSQ	0.77			
Intercept	-0.11			

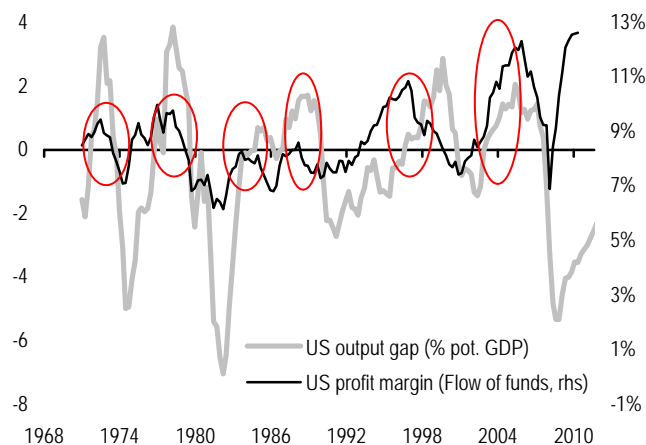
Historically, 2% GDP growth is needed for positive EPS but in 1H of year GDP was just 0.8% and EPS was up 12% yoy (ex financials). And we think that the breakeven is lower (because we forecast unit labour costs rise by 0.9% and output prices by 1.2%)

Historically, EPS declines when real GDP growth falls below 2% but this time around we can see that the break-even has fallen



Margins are extremely high as is the profit share of GDP but typically margins peak 8 months after a peak in the output gap. We find that profit margins have never peaked until wage growth is above 3.5%, compared to 2.3% currently in the US.

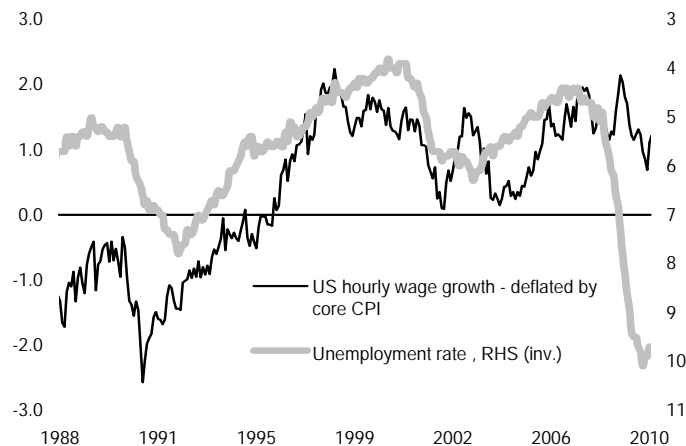
US margins peak when the output gap closes...



... more specifically, they have typically peaked seven months after the output gap closed

Peak in margin	Output Gap	Output Gap turns positive	Lead (mm)
Mar-73	3.5%	Jun-72	9
Sep-77	0.2%	Sep-77	0
Jun-84	-0.1%	Sep-85	-15
Dec-88	1.7%	Sep-87	15
Sep-97	0.3%	Jun-97	3
Sep-06	1.3%	Dec-03	34
Average	1%		8
2011E	-3%	Dec-12E	

Labour is unlikely to regain pricing power until the unemployment rate fall below c7%...

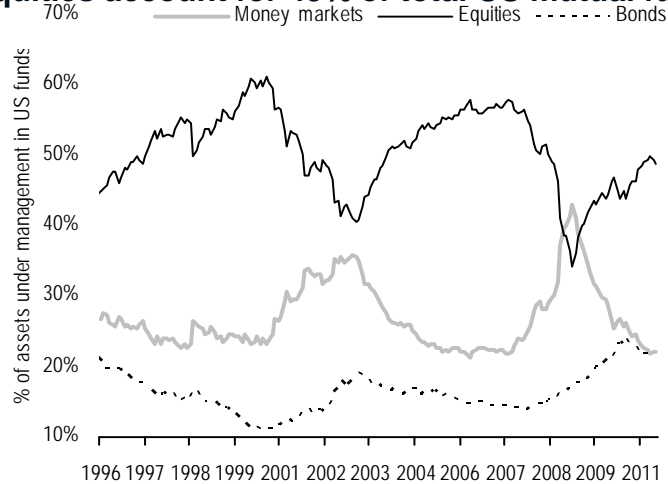


... but profit margins tend to peak when wage growth has accelerated to above 3.5% and on average 21 months after a trough in wage growth

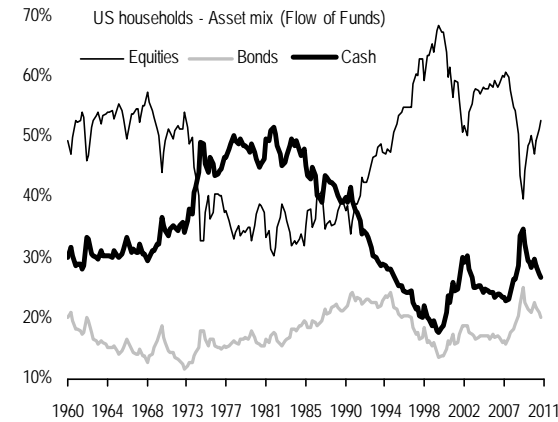
Peak in US margin	US Wage growth, yoy	Trough in wage growth	Lag (mm)
Jun-84	3.5%	Aug-83	10
Dec-88	3.5%	Dec-86	24
Sep-97	3.7%	Mar-96	18
Sep-06	4.1%	Feb-04	31
Average	3.7%		21
Current	2.3%		4

Long-term investors – insurance companies and pension funds – are still, if anything, short of equities. Household weightings in equities as a proportion of financial wealth are back to close to average levels

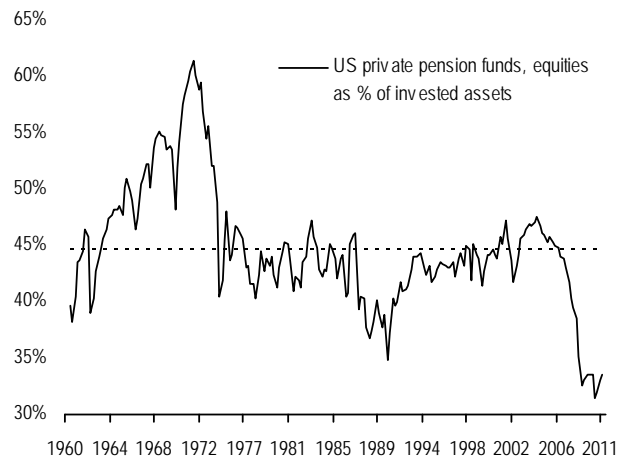
Equities account for 49% of total US mutual fund assets



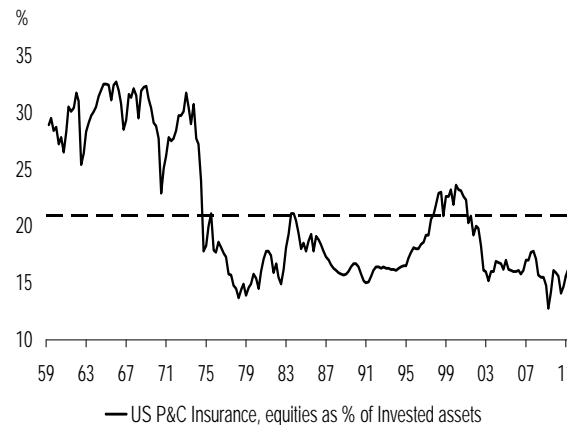
53% of US households' total financial assets



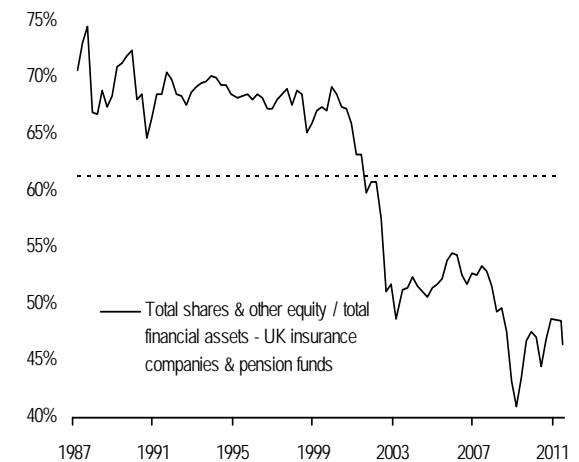
Equity weightings of US pension funds are well below average



Equity weightings are close to all-time low for US P&C insurance companies



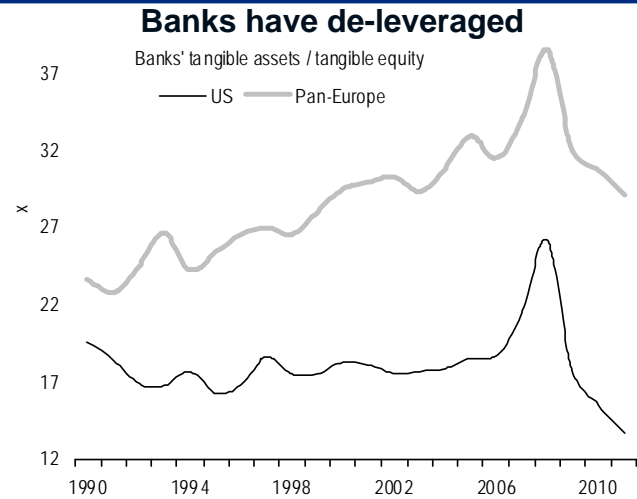
Equity weightings are still low for UK pension funds



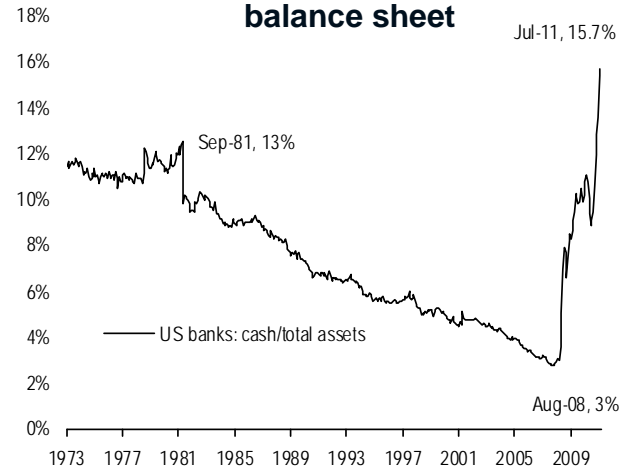
What's different from 2008? The following are better than in 2008...

- **Banks have de-leveraged and are better capitalized. Insurance companies have better solvency. Better liquidity in the banking system** (Central banks are effectively provided unlimited term funding to the domestic banks and the cash now accounts for 16% of US banks' balance sheet compared to 3% in 2008).
- **Better transparency of banks' balance sheets** – i.e. we know who owns what (owing to stress tests)
- **The non-financial corporate sector has more solid balance sheets and is under-invested.**
- **The cost of BBB corporate debt and IL bonds yields are falling** (they were rising v sharply in 2008)
- **Central banks are quicker to provide emergency funding (and have the facilities in place)**
- **US households' debt to income ratio now in line with trend and the debt service ratio**
- **US housing is much cheaper and for the first time since 2006, the vacancy rate is below trend.**
- **Money market funds are much less vulnerable to a credit/liquidity crisis.**
- **Policy makers are more willing to react to the risk of disorderly defaults** (i.e. a Lehman's type event).
- **Earnings revisions in the US are much-much better than in 2008.**

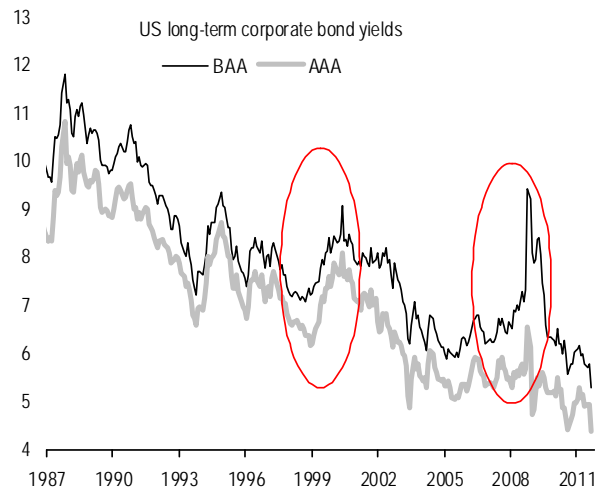
What's better than 2008? Banks have de-leveraged and are better capitalized. Better liquidity in the banking system. The cost of corporate debt and index linked bonds yields are falling (they were rising in 2008)



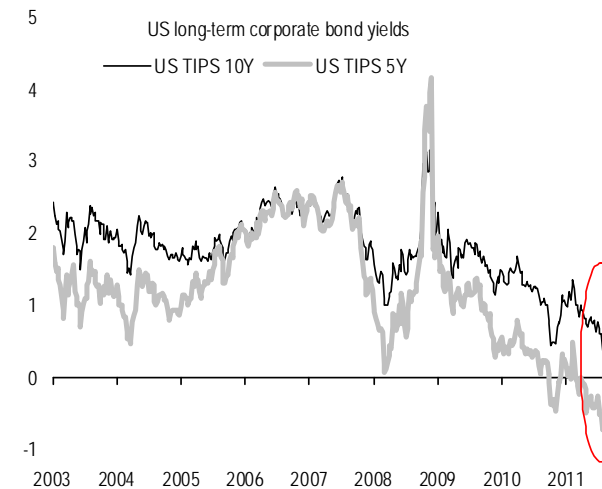
US banks' cash assets are now almost 16% of their balance sheet



The cost of debt for corporates is at record lows ...

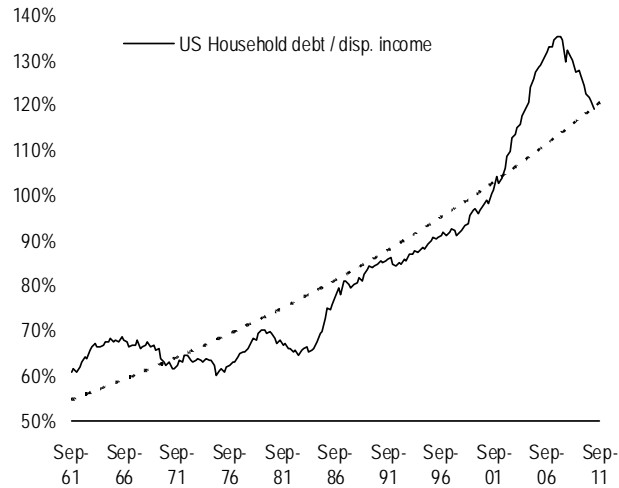


... and index-linked government bond yields are negative

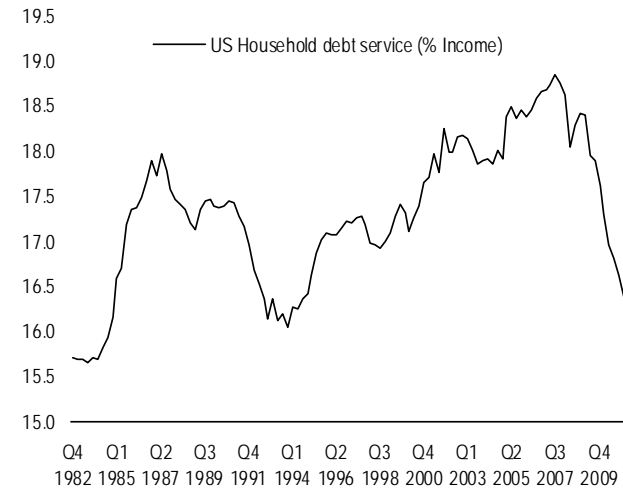


US households' debt-to-income ratio is now in line with trend and the debt service ratio much lower than it was in 2008. US housing is much cheaper and for the first time since 2006, the vacancy rate is below trend

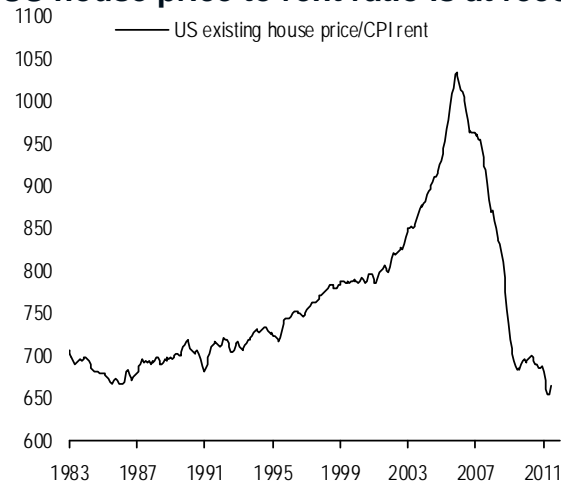
The US consumer debt to GDP ratio is back at trend ...



... and the debt service ratio falls to a 15-year low



US house price to rent ratio is at record low

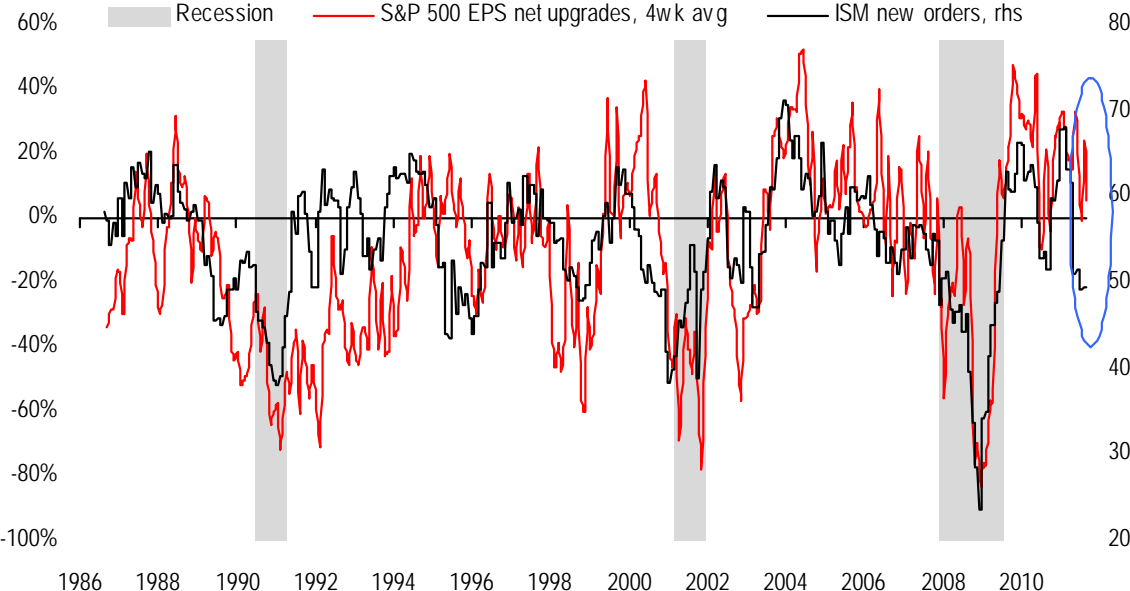


... and the US housing vacancy rate is below trend



Earnings revisions are much better than preceding previous recessions

Earnings breadth in the US



Why US is not like Japan in the 1990s 1) Deflation has become socially and economically acceptable in Japan, in our view. A rapidly ageing population with a large proportion of their financial wealth in short-term nominal assets (bank deposits still account for 56% of total household financial wealth and are equivalent to 174% of GDP) has an intrinsic bias in favour of deflation. BoJ has single mandate, the Fed dual.

Japan's household cash assets are 174% of GDP and 56% of total assets

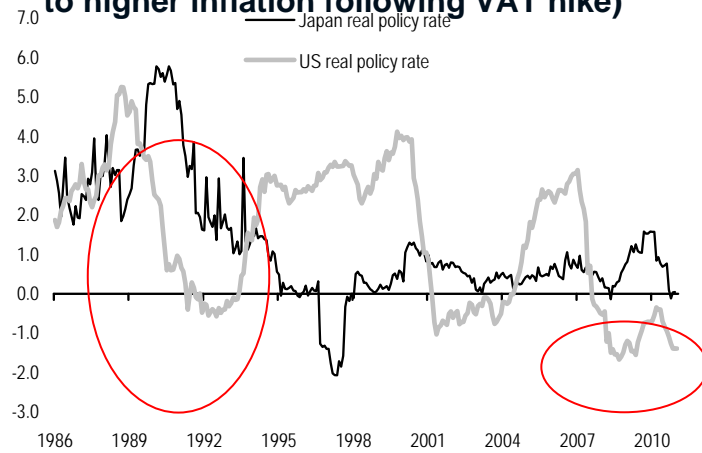
	Household's liquid assets		Household's net financial assets	Impact on net wealth of a 10% fall in the CPI
	% GDP	% financial assets	% GDP	% GDP
Japan	174%	56%	110%	11%
US	53%	16%	-35%	-4%

Cash minus financial liabilities

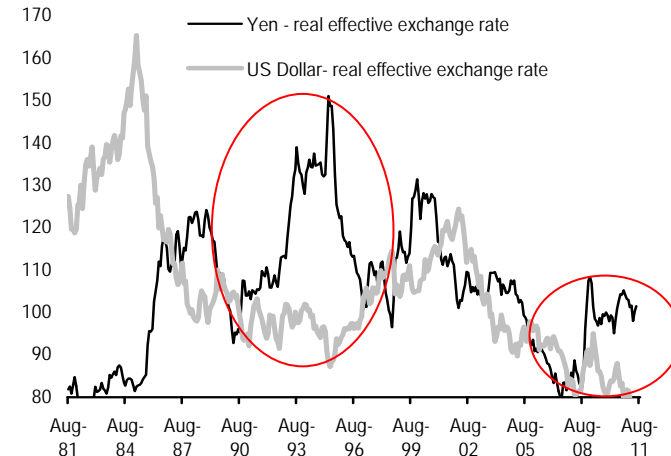
Deflation is positive with net cash position!

US Policy makers are more pro-active today ... Japan real rates were on average 1.5% in the 1990s compared with -0.9% on average in the US since 2008 (low real rates support asset prices, reduce the savings ratio and the required fiscal tightening). This reflects the Fed's credibility in its efforts to drive inflation expectations higher vs the BOJ. The result has been an overvalued Yen in the 'lost' decade, whereas the US\$ trade-weighted is at record lows.

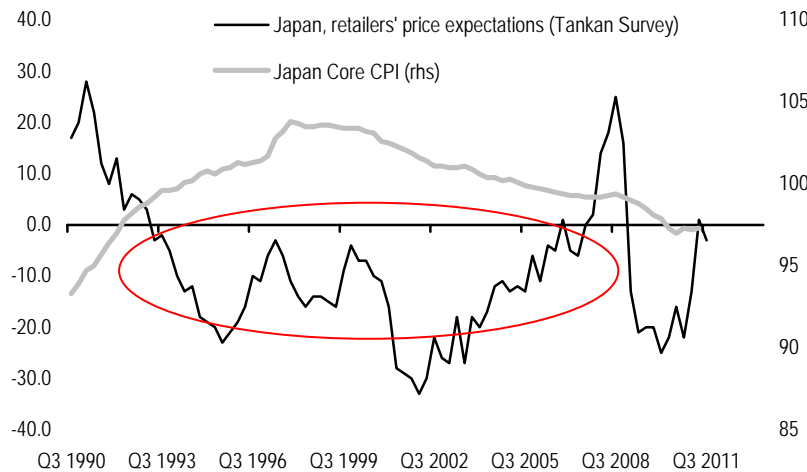
Japan' real rates were only negative in 2H 1997 (due to higher inflation following VAT hike)



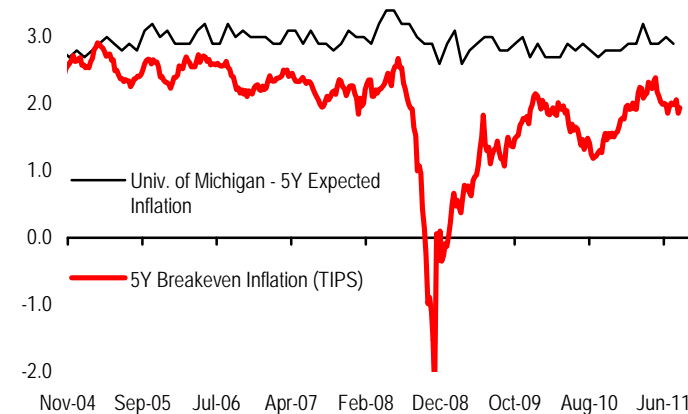
Yen was overvalued in the 1990s, the dollar is now trading at record lows



Japan's inflation expectations turned negative in 1993

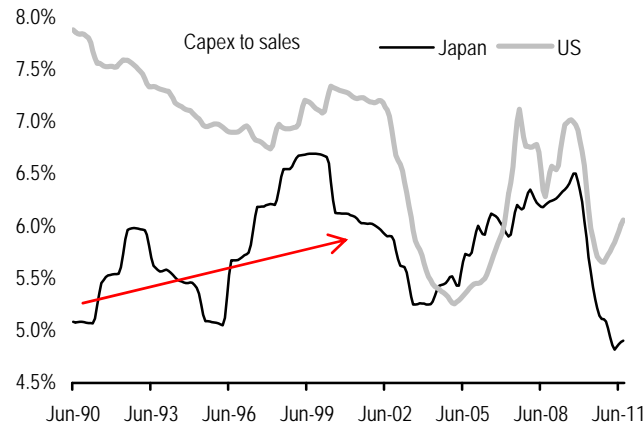


5Y US inflation expectations still at 2-3%

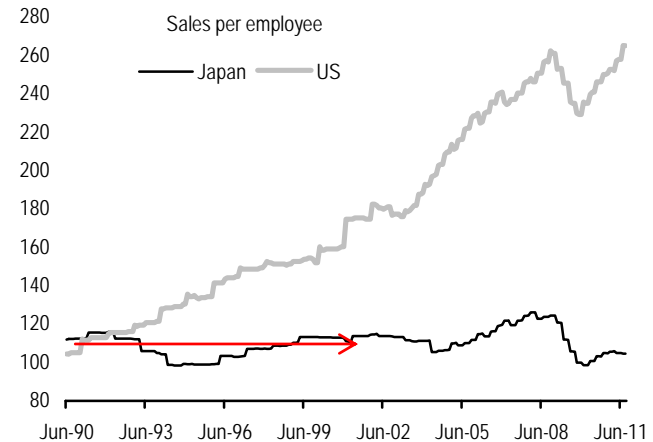


2) No financial/operational restructuring and little economic de-regulation – with the postponement of significant cost-cutting – made Japan vulnerable to NJA competition. We believe this is partly due to the limited use of share options and equity raising as a source of capital, as well as the lack of aggressive M&A (we note that we have seen evidence of improving corporate governance in Japan).

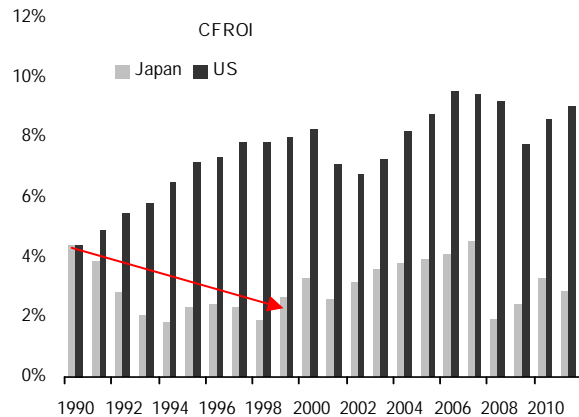
Sharp deterioration in capital efficiency in Japan during the 1990s



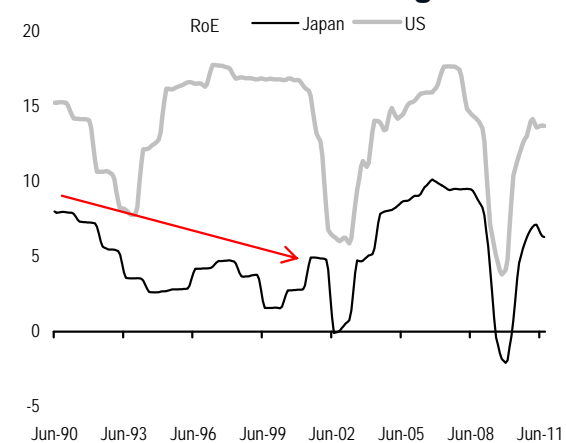
... And falling sales per employees (in the US they have more than doubled)



... resulting in a structural downtrend in CFROI in Japan during the 1990s

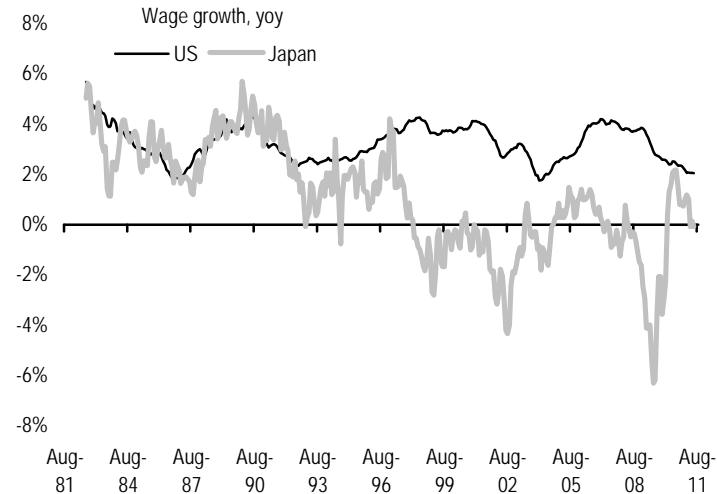
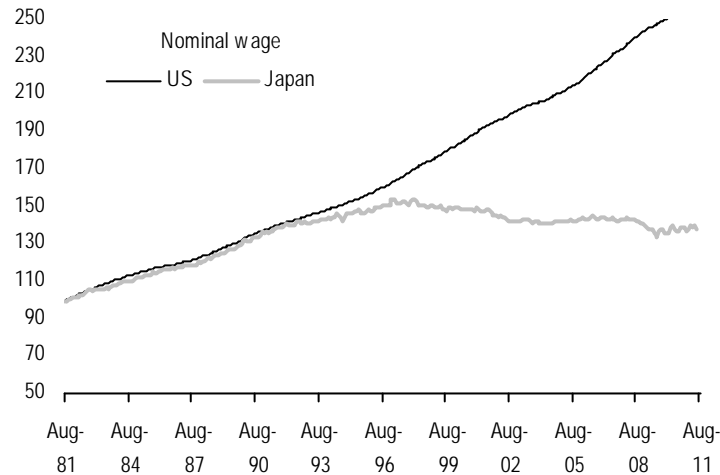


... as well as declining ROE

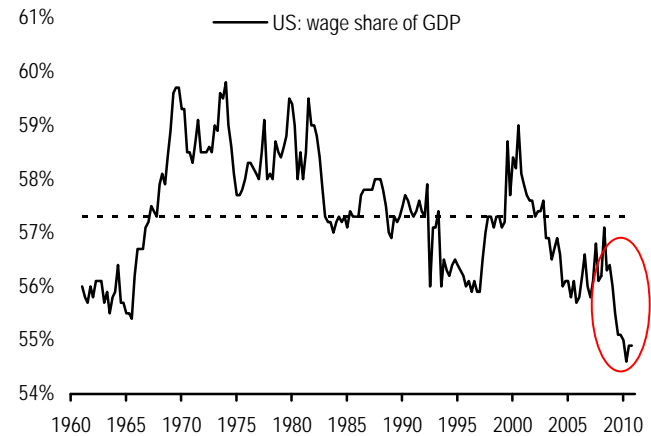
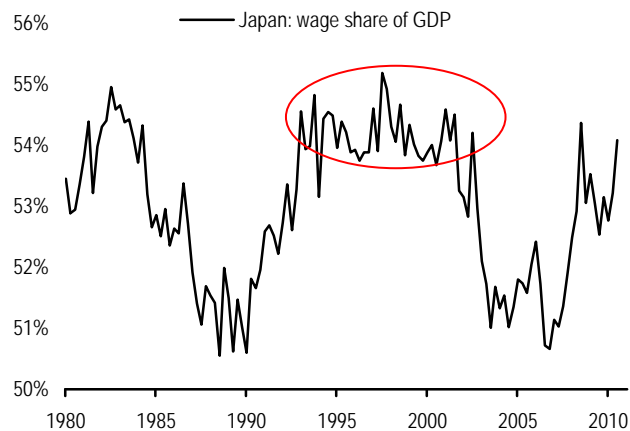


Hence, nominal wages are rising 2% a year in the US, while in Japan hourly wages are still 10% below previous peak and still falling. Wages account for c70% of inflation, so deflation is unlikely if wage growth is positive. We believe the reason why wages fell in Japan was the lack of aggressive job-cutting (so that the only way to cut compensation cost was to cut wages). In the US, employment has been cut by 6.2% since 2007 and wages as a % of GDP are now at a record low (in Japan, it hit a record high in the late 90s).

Japan's nominal wages fell, in the US they are still rising at 2% yoy

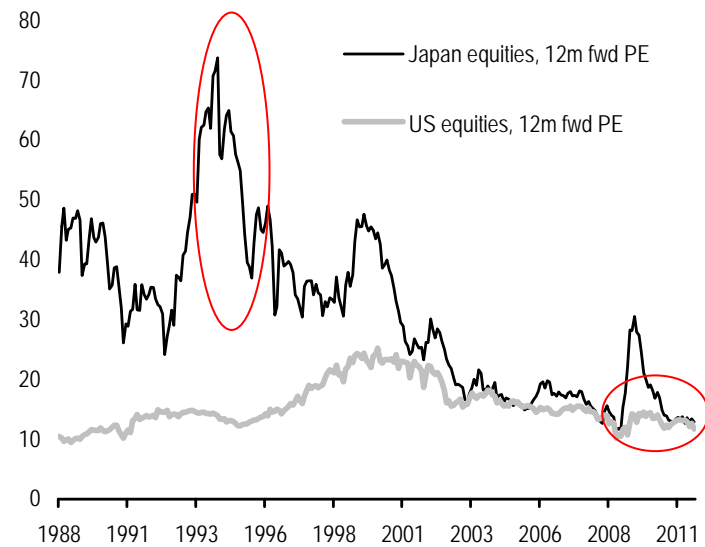
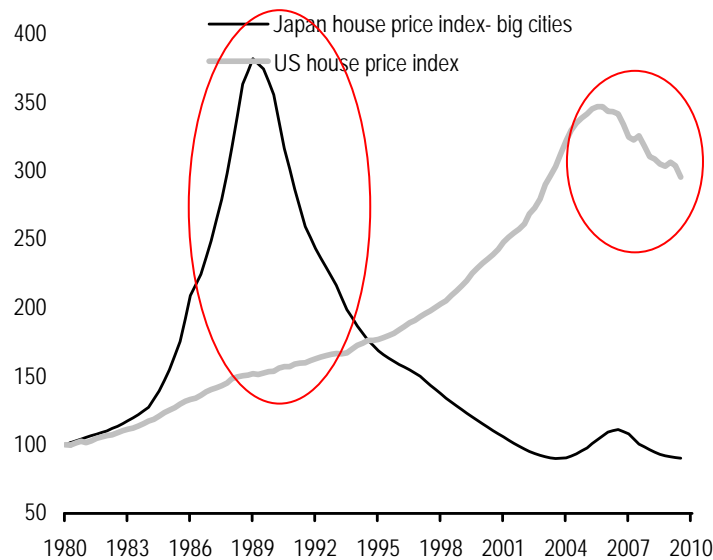


Japan's wage share of GDP was at historically high levels in the mid 90s, in the US it is now at record low



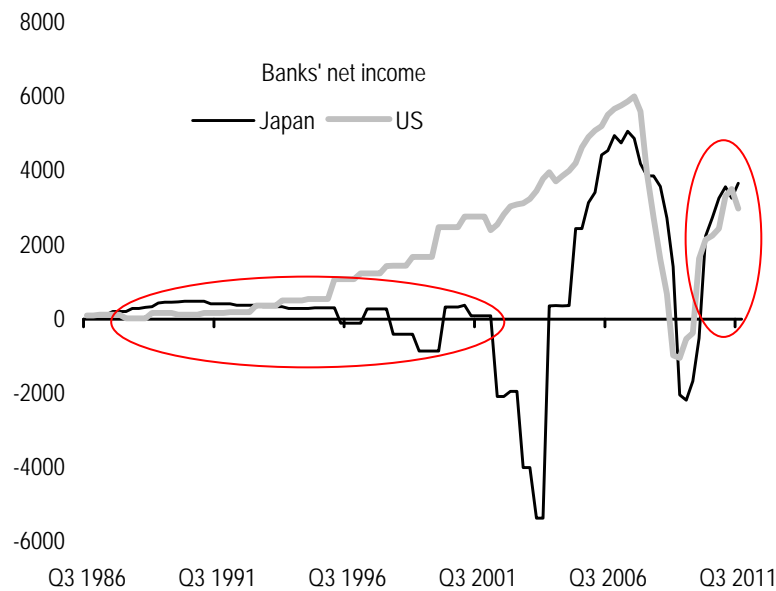
3) The degree of asset deflation was much more acute in Japan, as stock and house prices were much more overvalued at the peak. House prices are 76% below their peak in 1989, in the US only 21% below. In 1994, Japan's equities traded at a 12m PE of 74x compared to a peak valuation of 16x in the US at the end of 2007.

House prices and stock prices much more overvalued in Japan than in the US

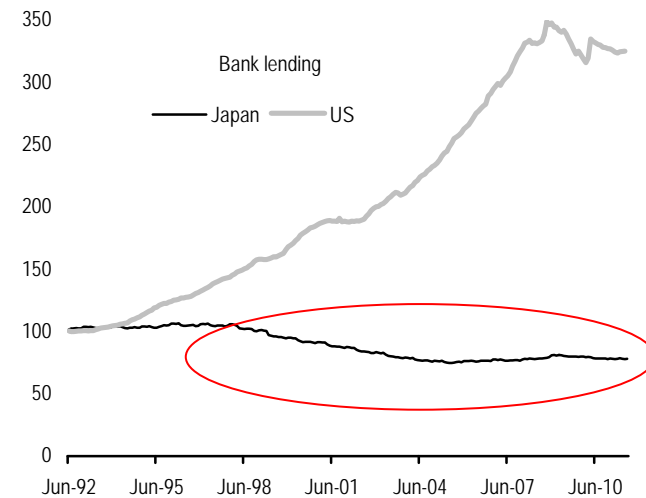


4) US banks appear in better shape than Japanese banks ... According to the official figures, total credit losses in Japan have been Y93trn or 19% of GDP (of which Y44trn in public support). Total losses for US banks are c\$1trn (6% of GDP). Thus as a proportion of GDP, the losses for banks were more than three times those of the US. As a consequence, Japanese banks have lost money for a decade and cut back on lending significantly.

The Japanese financial sector has not been profitable for a decade, in the US it is highly profitable again

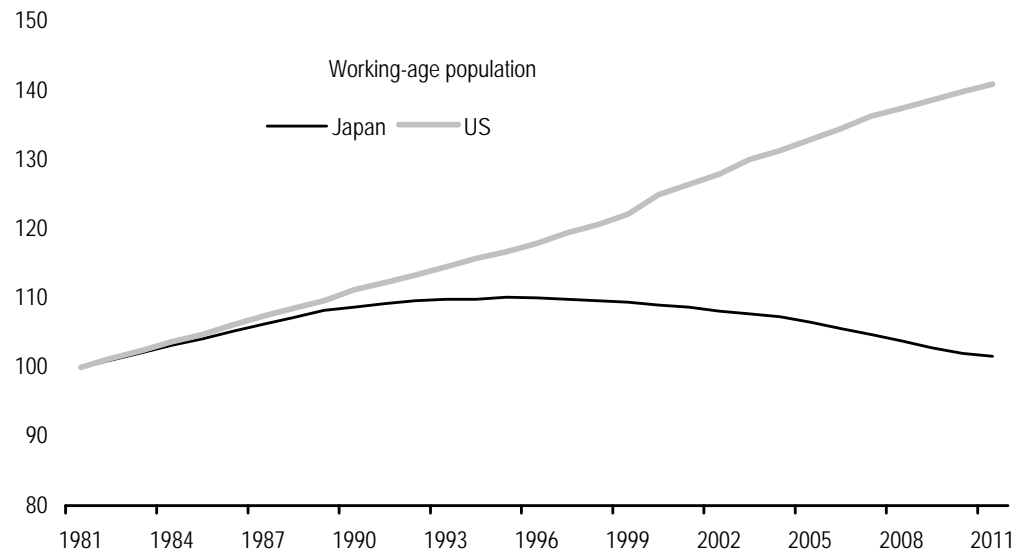


Bank lending in Japan is 30% below peak



5) Japan has much worse demographics... The labour force peaked in 1998 at 67.9m and has declined at an annual rate of 0.2% since then – our Japan economics team forecasts an annual decline of 0.7% over the next 10 years. In the US, the labour force has increased by 0.8% p.a. over the last 10 years.

Japan's working age population has been shrinking since 1998



Key themes

Buy:

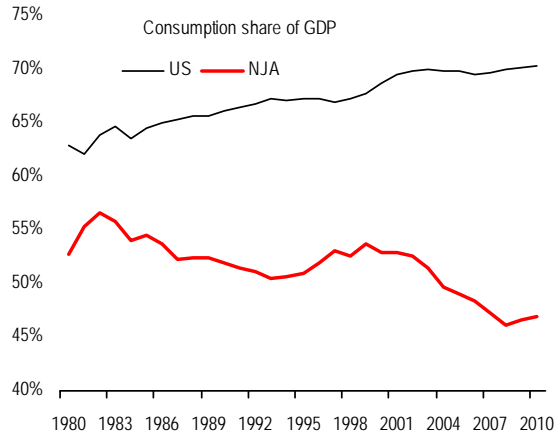
- BRIC consumer
- Plays on real rates being kept abnormally low
- Growth

Sell:

- China as a threat

KEY THEME 1: Emerging market consumer. NJA and GEM consumption share of GDP has to rise (the China consumer share of GDP is just 35%). And it is rising!

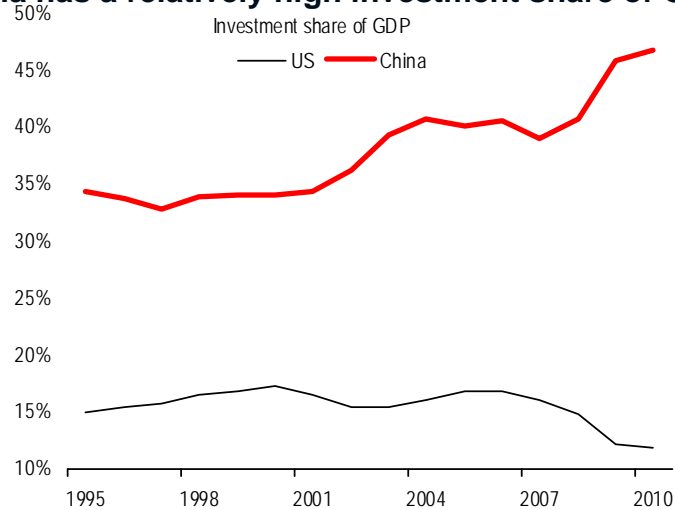
NJA countries have a low consumption share of GDP



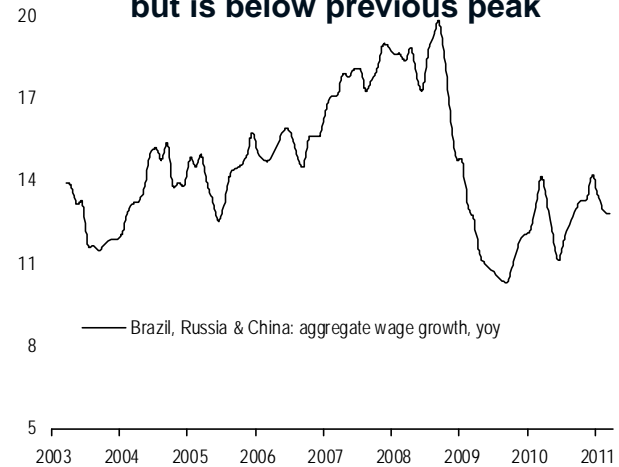
China real retail sales have fallen, but are in line with recent average



China has a relatively high investment share of GDP

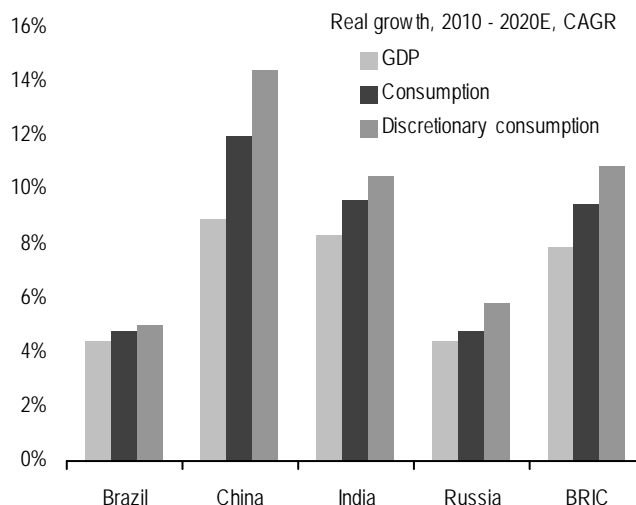


Wage growth in BRIC has risen from its trough, but is below previous peak



If China grows by 9% per year in real terms between now and 2020, then consumption is likely to grow by 12%, and discretionary spending by 14%

Country	GDP Real trend growth	Consumption			Discretionary consumption (% of total)		
		Consumption share of GDP 2010	15y max	Implied real growth	2007	2020E	Implied real growth
Brazil	4.4%	63%	65%	4.8%	64%	65%	5.0%
China	8.9%	36%	48%	12.0%	52%	65%	14.4%
India	8.3%	57%	65%	9.6%	55%	60%	10.5%
Russia	4.4%	54%	56%	4.8%	59%	65%	5.8%
BRIC	7.9%	46%	54%	9.5%	56%	64%	10.9%
<i>Developed countries</i>	2.4%	65%			74%		



How to play NJA? Direct NJA consumer plays: we would focus on our NJA analysts' preferred domestic consumer plays. Of these, we would highlight that China Mobile and CCB are Neutral and Outperform-rated respectively by our analysts and look cheap on HOLT

Our NJA analysts' preferred domestic consumer plays

Name	-----P/E (12m fwd) -----			----- P/B -----		Yield (2011e)		HOLT	Momentum		Consensus (buy less holds & sells)	Credit Suisse rating
	Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Price, % change to best	3m EPS	3m Sales		
China Mobile Ltd	9.9	76%	1%	2.6	12%	7.2%	4.4%	87.3	0.2	0.2	-14.3	Neutral
Hero Honda	16.4	215%	90%	11.3	106%	4.2%	3.3%	-3.2	-1.0	2.3	-41.5	Outperform
Tencent Hldgs Limi	21.0	167%	n/a	14.1	n/a	3.6%	0.5%	-4.4	-3.0	0.9	65.7	Outperform
China Const Bk	6.0	78%	-40%	1.8	-13%	n/m	6.0%	36.2	-0.3	2.1	68.8	Outperform
Htc Corporation	8.5	82%	8%	8.9	52%	10.2%	6.8%	100.9	1.5	2.2	42.9	Outperform
Ind & Com Bk China	6.4	83%	n/a	2.0	n/a	n/m	5.7%	25.0	-0.1	0.9	71.4	Outperform
P.T. Astra Intl	15.6	204%	130%	4.6	195%	4.4%	2.5%	-13.1	7.2	6.0	20.0	Neutral
Gudang Garam Tbk	19.7	155%	144%	4.8	185%	4.9%	1.7%	-33.9	-1.1	0.5	75.0	Outperform
Asian Paints Ltd	27.5	260%	134%	14.1	169%	1.2%	1.2%	-28.7	-1.6	0.1	21.7	Outperform
Cdl Hospitality Tr	14.6	n/a	n/a	1.2	n/a	n/m	6.8%	-1.2	-5.4	-1.3	44.4	Outperform
Belle Internationa	22.3	186%	n/a	7.8	n/a	3.9%	1.8%	-49.7	1.1	0.7	53.9	Outperform
Anta Sports Produc	10.3	71%	n/a	4.4	n/a	8.5%	5.4%	-3.0	0.4	1.7	38.5	Outperform
Amorepacific (New)	22.2	133%	n/a	4.6	n/a	2.4%	0.5%	-43.0	-0.1	1.3	25.0	Outperform
Indosat Tbk	19.6	151%	145%	1.7	10%	5.7%	1.8%	-23.3	0.3	-1.6	4.8	Outperform
China Mengniu Dair	19.4	136%	17%	4.7	20%	2.2%	1.0%	-45.1	1.9	1.8	76.0	Outperform
Gome Electrical Ap	15.9	133%	32%	3.9	-16%	3.4%	1.7%	-49.3	2.5	-0.9	66.7	Outperform
Parkson Retail Gro	16.5	148%	n/a	5.7	n/a	4.3%	2.3%	-22.5	-1.1	-0.7	-57.1	Outperform
Land & Houses	15.0	113%	33%	2.4	8%	n/m	5.6%	-54.1	-4.1	-1.6	44.4	Outperform
Lg Household&Healt	27.6	200%	179%	11.0	288%	3.8%	0.6%	-67.2	-6.5	8.3	37.9	Outperform
President Chain St	23.4	203%	106%	8.9	190%	4.9%	3.1%	-59.4	2.0	0.3	40.0	Neutral
Sands China Ltd	21.1	142%	n/a	44.5	n/a	n/a	0.0%	n/a	12.8	0.6	70.0	Outperform

Indirect plays: We show list of European companies with significant sales exposure to NJA and China consumer. Ranked by exposure to NJA consumer. Stocks that look cheap on Credit Suisse HOLT® or have a FCF yield above 5% are: Sabmiller, BAT, Danone, Swatch, Richemont, HSBC, Henkel, Mill & Copp, Diageo, BMW, Reckitt, Wpp, Imperial Tobacco)

European stocks with high exposure to the NJA consumer

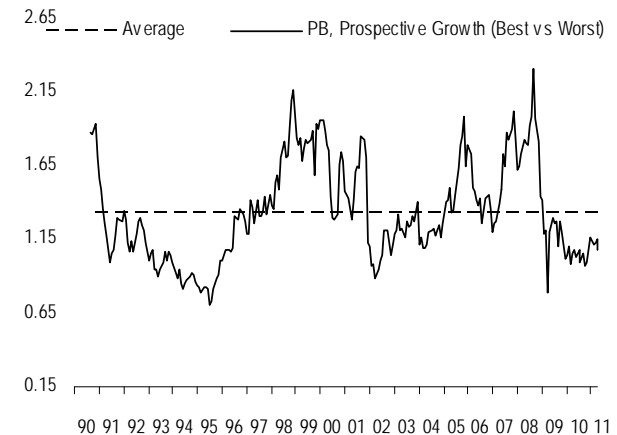
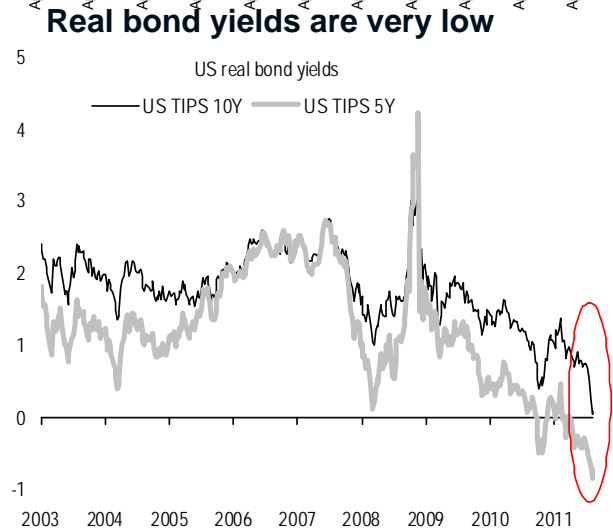
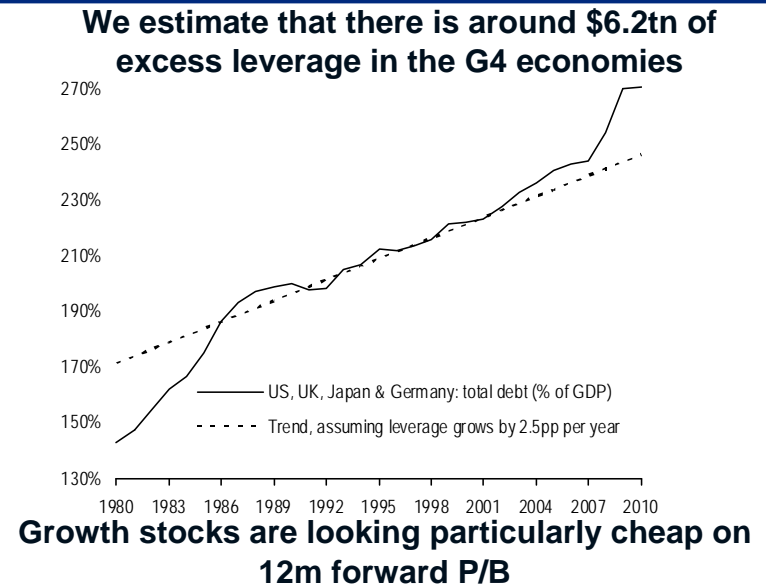
Name	% Sales from GEM	% Sales from NJA	% Sales from China	-----P/E (12m fwd) -----			----- P/B -----		Yield (2011e)		HOLT Price, % change to best	Momentum		Consensus (buy less holds & sells)	Credit Suisse rating
				Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY		3m EPS	3m Sales		
Sabmiller	67%	16%	n.a	14.1	104%	55%	1.4	0%	6.0%	2.8%	-6.5	1.8	-0.8	-47.8	NR
Prudential	60%	60%	n.a	9.0	112%	12%	1.9	-46%	n/m	4.3%	-22.6	4.7	4.9	44.0	Outperform
Brit Amer Tobacco	59%	19%	n.a	12.8	101%	79%	5.8	102%	7.3%	4.7%	-15.5	1.5	0.5	9.1	Neutral
Unilever Plc	48%	19%	n.a	14.0	98%	58%	3.9	3%	5.5%	3.8%	-26.9	0.4	1.0	50.0	NR
Danone	43%	10%	5%	14.6	102%	42%	2.5	30%	5.5%	2.9%	-28.8	-1.0	0.0	15.0	Neutral
Swatch Group	40%	36%	37%	13.4	92%	55%	2.7	53%	6.1%	1.9%	-15.8	-1.3	-0.2	30.8	Outperform
Richemont(Cie Fin)	40%	34%	26%	14.3	99%	69%	3.3	89%	5.5%	1.5%	-4.2	-3.8	3.2	21.4	Neutral
Hsbc Holdings Plc	40%	27%	17%	7.9	104%	10%	0.6	-55%	n/m	4.9%	22.1	1.5	-0.9	10.3	Neutral
Anheuser-Busch Inb	40%	4%	n.a	13.3	97%	n/a	1.7	n/a	7.1%	2.3%	-26.3	-0.1	-1.0	52.9	NR
Henkel Ag&Co. Kga	38%	8%	3%	12.1	88%	25%	2.3	29%	7.6%	1.9%	6.4	-0.2	0.1	5.3	Neutral
Carlsberg	38%	7%	n.a	9.0	66%	-17%	0.9	-44%	11.3%	1.6%	-17.3	-8.3	-1.0	14.3	NR
Remy Cointreau	37%	33%	n.a	19.3	142%	73%	2.7	141%	4.4%	2.6%	-26.7	4.7	0.2	-25.0	NR
Nestle Sa	36%	11%	3%	15.6	109%	66%	2.8	21%	5.1%	3.9%	-26.6	-7.7	-11.0	-12.8	Restricted
Lvmh Moet Hennessy	35%	23%	14%	16.3	112%	47%	3.1	36%	4.9%	2.2%	-23.7	2.4	2.3	37.9	Restricted
Millennium&Coptne	33%	33%	n.a	11.7	79%	10%	0.7	38%	7.5%	2.8%	13.8	-1.1	-0.4	71.4	Outperform
Volkswagen Ag	32%	23%	26%	n/a	n/a	n/a	0.9	-3%	n/a	n/a	n/a	n/a	@ NA	n/a	Restricted
Beiersdorf Ag	32%	10%	6%	21.2	127%	48%	3.5	8%	4.7%	1.8%	-31.9	2.2	-0.9	-75.0	Neutral
Bulgari Spa	31%	23%	na	34.1	236%	166%	4.0	37%	2.7%	1.4%	-66.0	0.9	0.1	-100.0	Restricted
Diageo	31%	7%	n.a	13.2	97%	48%	5.9	111%	6.7%	3.6%	-14.3	0.2	0.0	29.4	Outperform
Bayer Motoren Werk	30%	na	14%	7.2	94%	-10%	1.4	14%	12.5%	4.2%	60.0	17.9	2.9	-13.5	Outperform
Casino Guich-Perr	29%	8%	n.a	9.3	81%	-4%	0.8	-39%	1.3%	5.4%	-17.5	-3.2	3.4	8.3	Restricted
Carrefour	29%	7%	5%	9.6	83%	-16%	1.4	-54%	2.4%	5.5%	-10.1	-27.6	-11.2	-25.7	Restricted
Reckitt Benck Grp	28%	8%	1%	13.1	95%	31%	4.7	23%	7.2%	3.8%	-4.2	1.4	0.5	3.0	Outperform
Tesco	26%	14%	2%	9.8	84%	13%	1.8	9%	2.0%	4.2%	-15.1	0.1	-0.4	50.0	Outperform
Pernod Ricard	26%	8%	n.a	12.8	93%	46%	1.7	5%	6.6%	2.4%	-41.3	-0.2	0.2	9.7	NR
Wpp Plc	25%	11%	6%	8.8	85%	7%	1.2	-4%	13.2%	3.5%	-3.3	0.6	0.7	17.2	Outperform
Imperial Tobacco	20%	3%	n.a	9.8	78%	34%	2.8	-92%	11.2%	4.7%	114.3	-2.9	-1.6	45.5	Outperform
Cable & Wire Comm	82%	22%	n.a	8.1	80%	n/a	2.2	n/a	n/a	16.0%	n/a	-12.5	9.3	-45.5	NR
Telefonica Sa	48%	na	0%	8.0	79%	-6%	2.5	52%	12.8%	11.5%	24.3	-7.0	-0.7	9.1	Neutral
Telenor Asa	43%	35%	0%	9.4	93%	17%	1.5	8%	11.7%	5.2%	-3.2	2.5	-0.4	61.1	Outperform
Vodafone Group	37%	9%	0%	9.8	75%	-10%	1.0	-56%	11.7%	5.9%	-15.4	-1.6	1.0	54.3	Outperform
Meda Ab	28%	na	n.a	11.2	115%	n/a	1.4	n/a	16.5%	3.5%	-24.8	2.0	2.5	60.0	Outperform
Stada Arzneimittel	24%	na	n.a	8.8	90%	-20%	1.5	-2%	7.6%	2.7%	0.6	2.2	0.1	24.1	NR
Teliasonera Ab	24%	15%	0%	8.9	88%	-8%	1.6	34%	9.1%	6.8%	18.6	-4.2	-0.2	-18.8	Neutral
Sanofi	23%	1%	1%	7.5	77%	-28%	1.2	-25%	20.9%	5.3%	41.7	0.8	2.2	37.5	Outperform
Novartis Ag	23%	1%	1%	9.5	97%	-15%	1.6	-36%	9.2%	4.8%	64.2	1.9	0.7	50.0	Outperform

Key Theme 2: Real bond yields, we think, at 10 years have to be kept **NEGATIVE**

What to buy?

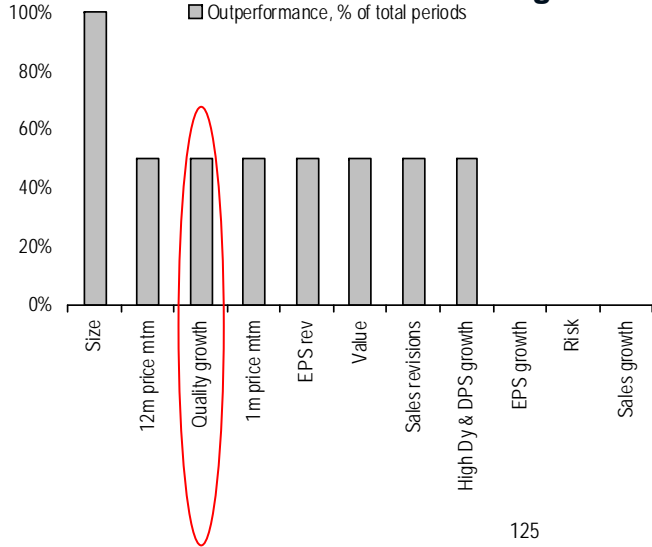
- 1) Cheap index-linked bond proxies**
- 2) UK Property**
- 3) Gold**
- 4) Stocks with high dividend yield and above average DPS growth**

KEY THEME 3 - focus on growth: a low discount rate favours long duration earnings; \$6.2trn of excess leverage remains a structural impediment long-term to growth in developed world; the output gap suggests that pricing will still be hard and cyclical growth is cheap.

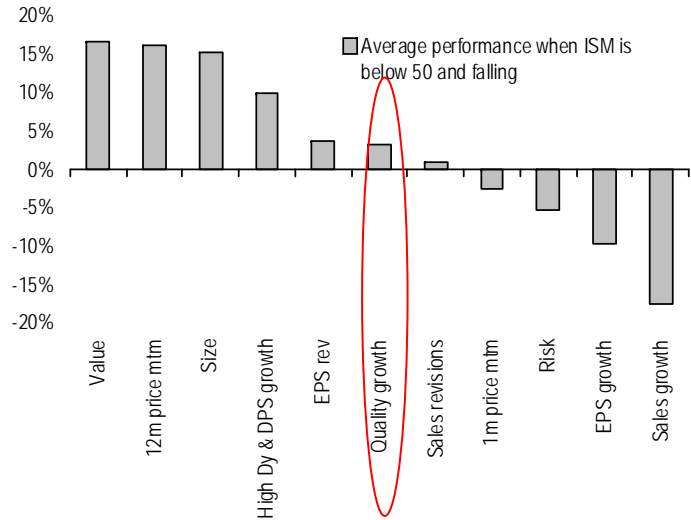


Favour growth. Quality growth outperforms other growth styles when the ISM is below 50 and falling.

Proportion of the time a style outperforms when the ISM is below 50 and falling



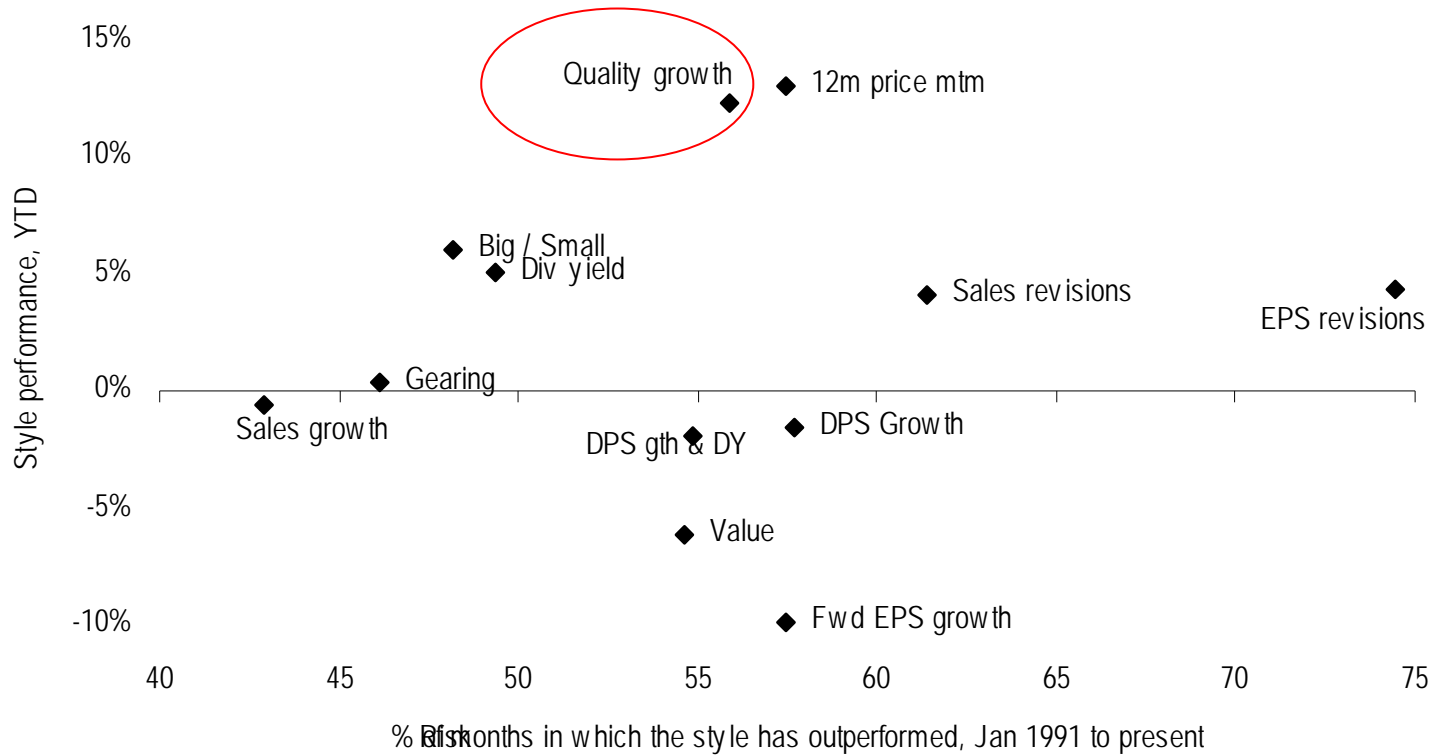
... outperforming by an average of 10%



Quality has outperformed the market

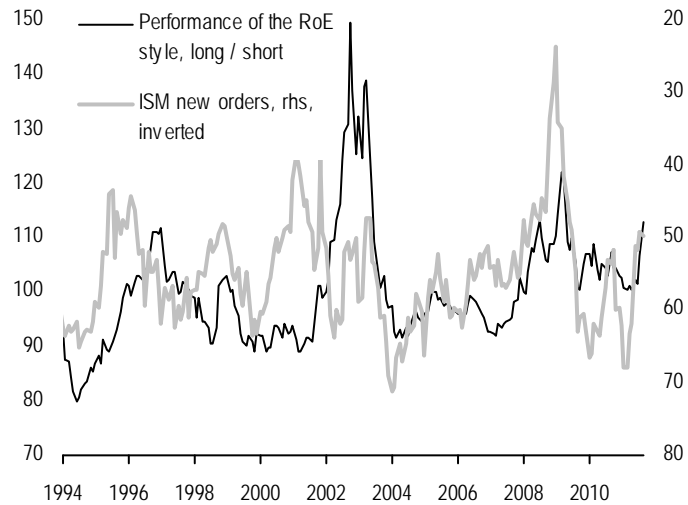


Quality growth with positive momentum

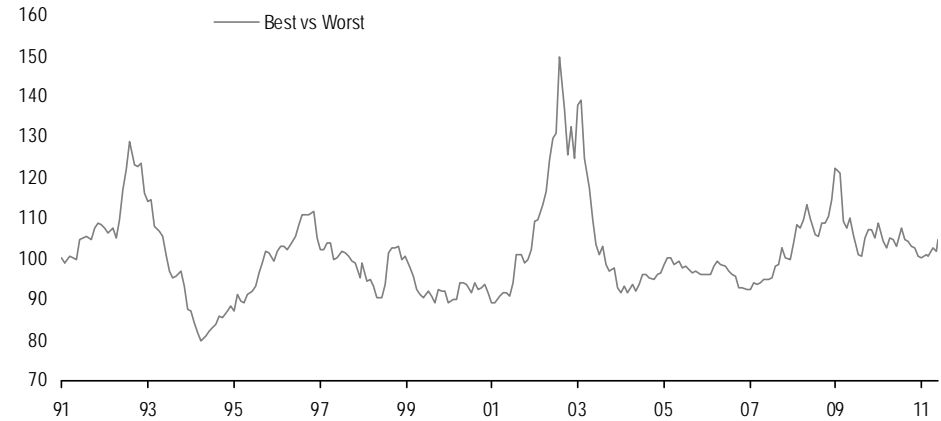


The style of buying high RoE stocks has worked in times of economic crises...

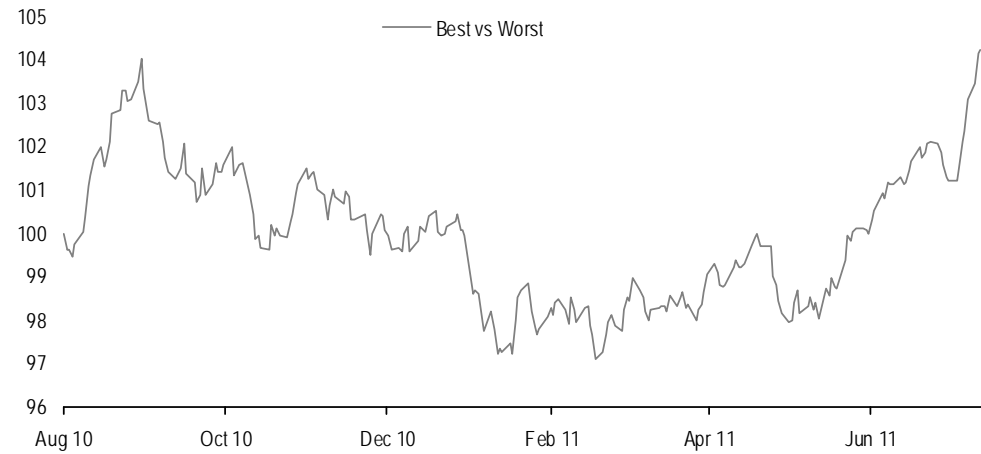
RoE style tends to outperform when ISM is falling



Performance of the RoE style since 1991

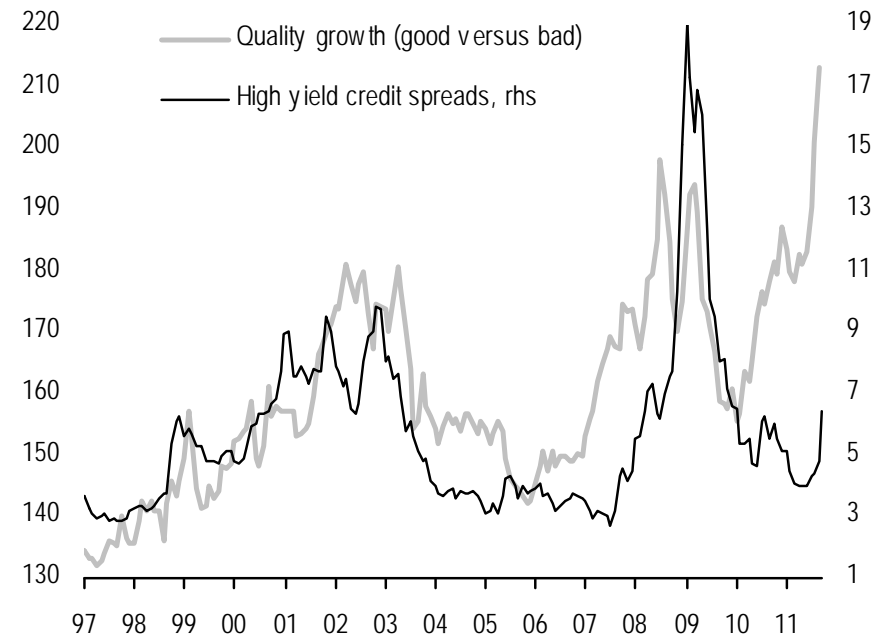
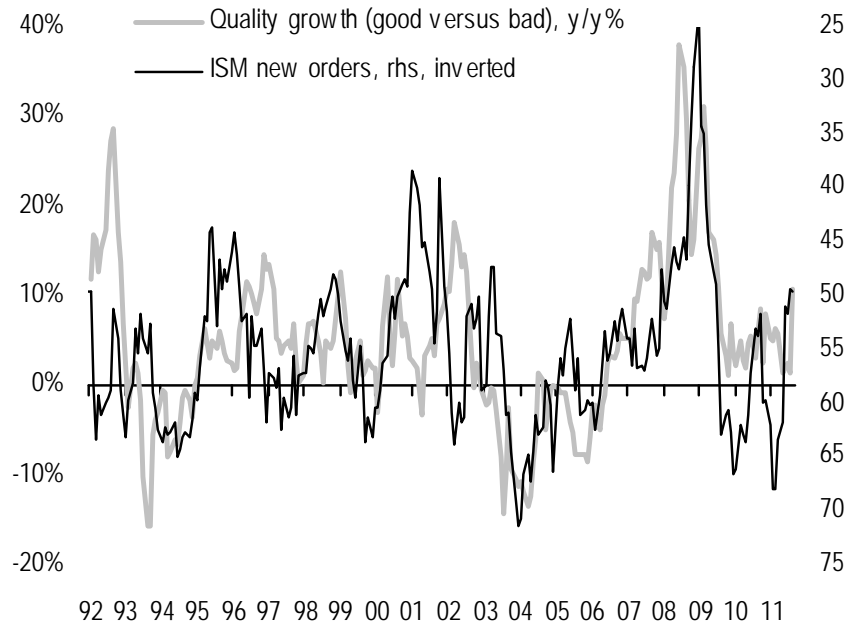


Performance of the RoE style over the last year



Still focus on growth stocks – quality growth outperforms when ISM peaks but stays above 50 and when credit spreads stop falling

Quality growth tends to outperform when lead indicators fall... and when credit spreads tighten



Outperform-rated quality growth stocks – superior historic and forward earnings growth and superior asset turns relative to peers

Outperform-rated quality growth stocks

Name	3 year historic EPS growth	2 year forecast EPS growth	Asset to sales	-----P/E (12m fwd) -----			----- P/B -----		Yield (2011e)		HOLT Price, % change to best	Momentum		Consensus (buy less holds & sells)	Credit Suisse rating
				Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY		3m EPS	3m Sales		
Basf Se	11%	6%	0.92	7.8	74%	0%	2.1	101%	13.7%	4.8%	55.5	1.6	1.7	16.7	Outperform
Wacker Chemie Ag	5%	15%	1.16	7.4	70%	n/a	1.8	n/a	1.8%	3.5%	40.0	-6.3	-1.2	35.5	Outperform
Ahold(Kon)Nv	10%	17%	0.48	8.7	75%	-4%	1.7	-16%	9.2%	4.1%	12.9	-3.5	-1.5	-17.7	Outperform
Yara International	6%	24%	1.00	7.6	72%	12%	2.0	7%	12.9%	2.5%	18.2	9.9	1.8	29.0	Outperform
Capita Group	18%	9%	1.01	13.4	n/a	-5%	8.6	29%	7.5%	3.1%	-1.2	-0.7	0.3	-7.7	Outperform
Alfa Laval Ab	1%	15%	1.05	11.4	113%	36%	3.4	26%	8.3%	3.2%	14.5	-0.5	1.2	-33.3	Outperform
Kuehne&Nagel Intl	4%	12%	0.34	15.4	155%	65%	5.2	27%	6.0%	3.2%	-27.1	-6.2	-8.0	-28.6	Outperform
William Demant Hol	5%	20%	0.95	16.9	137%	16%	9.5	-66%	4.8%	0.0%	-33.3	-0.3	-0.2	-13.0	Outperform

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