

# Global equity strategy

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# Macro, markets, themes and styles

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- **Macro still supportive**

- trend growth
- rates “lower for longer” – QE2
- Investment key growth driver. US employment to recover
- Emerging markets growth story intact
- Risks of de-leveraging, sovereign crisis, fiscal tightening and US housing exaggerated

- **Stay overweight equities (with a preference for emerging markets)**

- valuation OK
- leading indicators turning up again
- bearish positioning
- M&A/ buybacks
- seasonality

But: tactical indicators turning less positive and earnings revisions rolling over

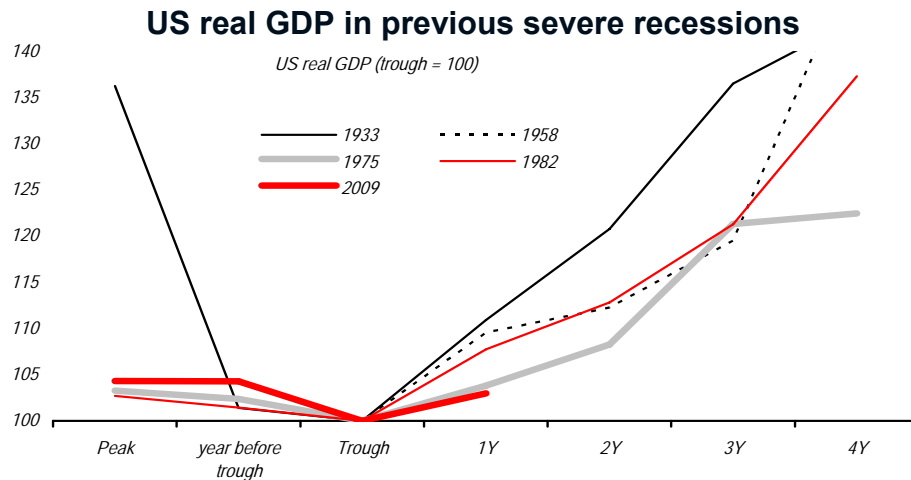
- **Macro/investment themes**

- BRIC consumer, M&A, pricing power, safer than government, avoid government exposure, QE

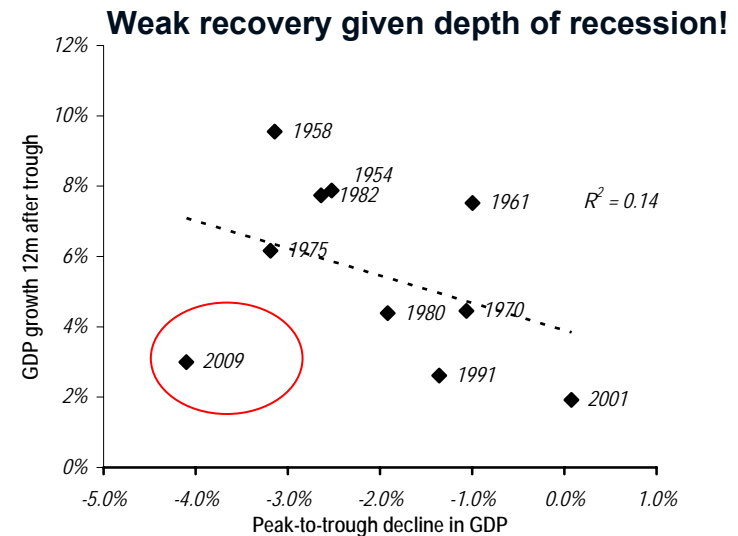
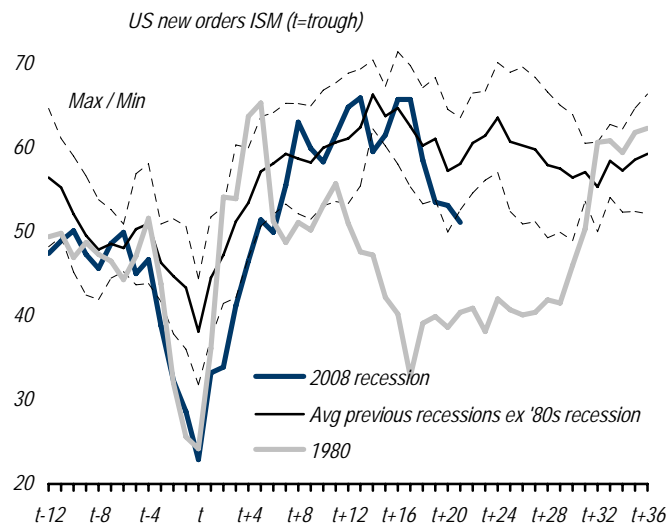
- **Styles**

- High growth, quality growth, high leverage, high dividend growth

This has of course been a muted recovery (for the depth of recession) although it is not usual for the ISM to have a mid-cycle pause.....



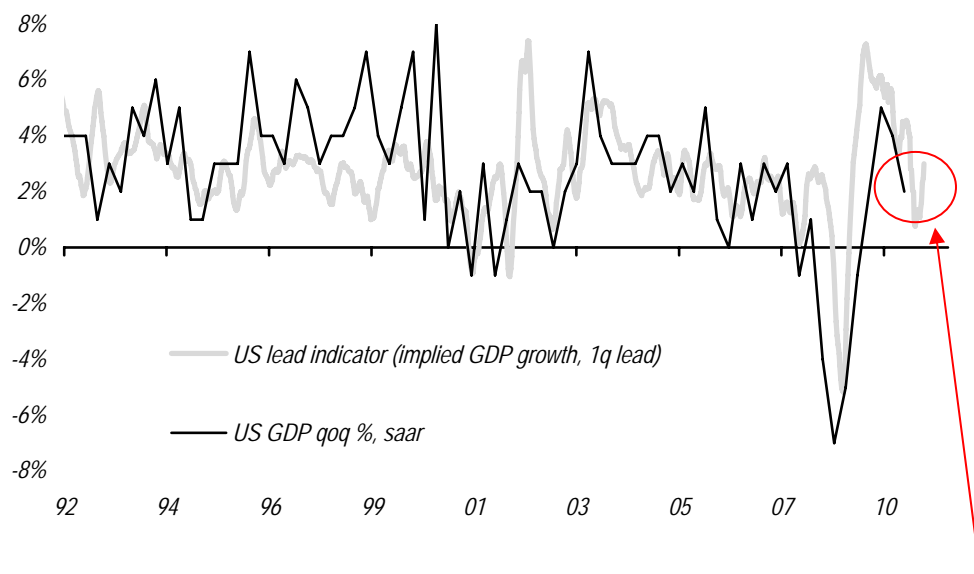
This is cycle looks similar to previous ones



ISM new orders					
	Peak		Temporary trough	Correction	
				Length (m)	Points
Nov-80	65.3	Jan-81	<b>48.7</b>	2	17
Jul-83	70.3	Sep-83	66.9	2	3
May-86	61.1	Jul-86	51.2	2	10
Sep-91	60.7	Dec-91	<b>49.5</b>	3	11
Jul-95	52.7	Jan-96	<b>44.1</b>	6	9
Jun-99	59.4	Jul-99	54.6	1	5
Aug-01	54.3	Oct-01	<b>38.9</b>	2	15
Dec-03	71.3	May-05	52.1	17	19
Average				4	11
Jan-10	65.9	Sep-10	51.1	8	15

# US lead indicators suggests c3% GDP annualized growth. Even US and global macro surprise have turned positive.

## Our US weekly lead indicator consistent with c3% GDP growth



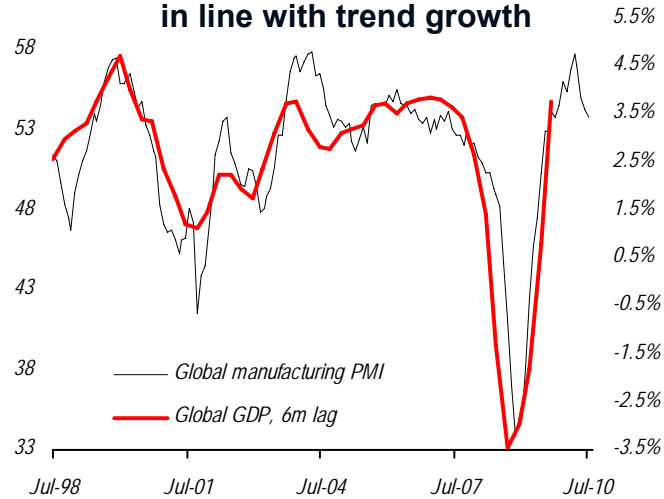
In last 7 weeks moved up to 3% from 1%

## Components of the US lead indicator:

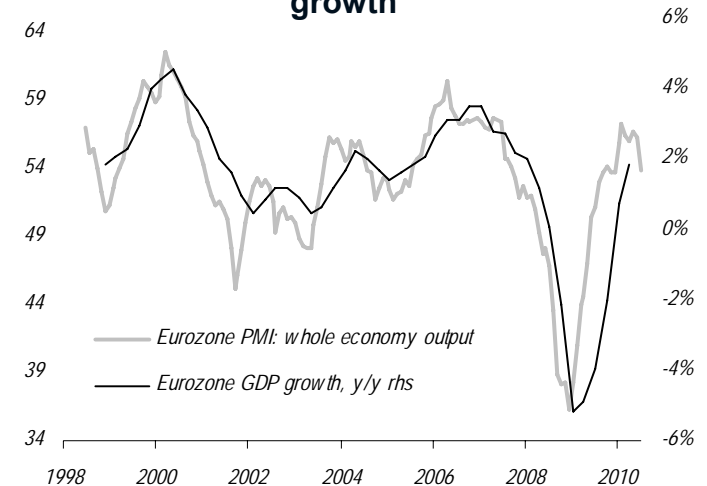
- ISN New Orders
- Jobless Claims
- Steel production Capacity
- Redbook weekly Retail Sales
- Money/ABC Consumer Comfort Index
- NAHB Housing Index
  
- CRB Raw Industrial Index
- Yield Curve (10y-3m)
- Corporate BAA - Treasury 10y spread
- Earnings Revisions ratio (s&p 500 Index)

**Global PMIs (Purchasing Managers Survey) have dipped but only marginally and it is still consistent with 3.5% global GDP growth and European PMIs are consistent with growth of 2%.**

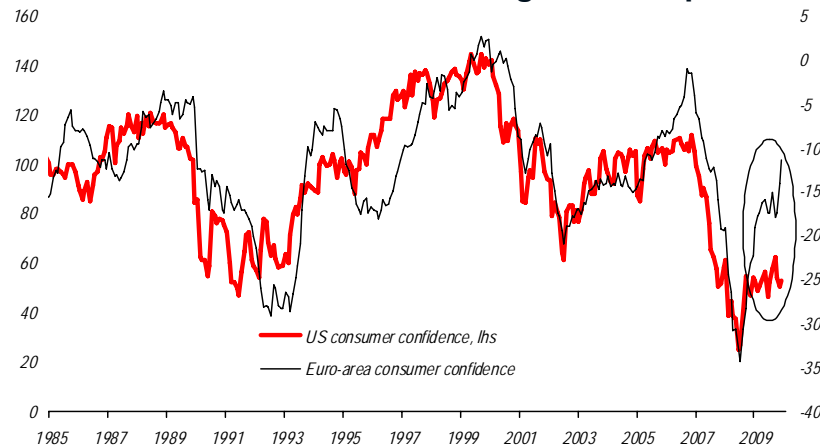
**Global PMI is consistent with 3.5% global growth – in line with trend growth**



**European PMI consistent with around 2% GDP growth**

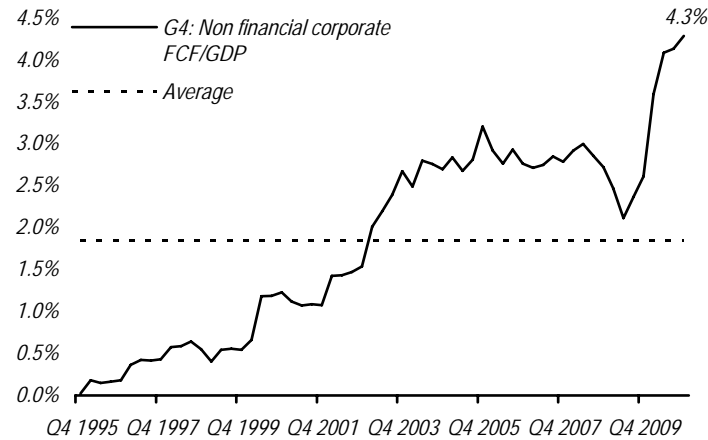


**Consumer confidence is much stronger in Europe than in the US**

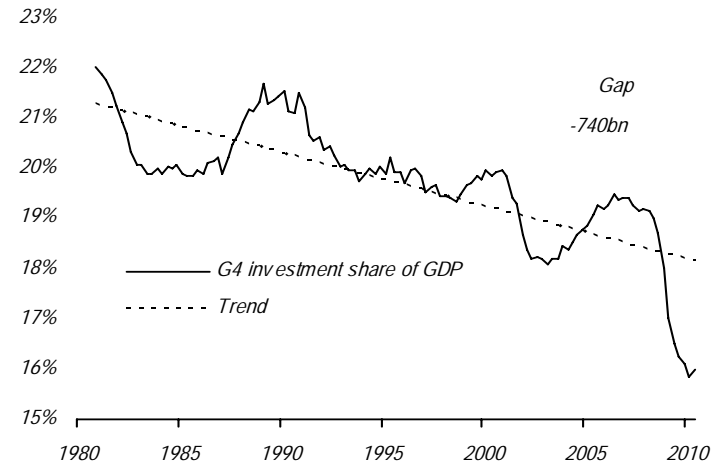


**Investment key growth driver: Corporates are under-invested. FCF is at all time high, gross investment share of GDP at all time low levels. The gross debt of the US non-financial corporate sector is 8% below trend. If FCF were to just normalise, then capex would rise by 49%! The return on tangible assets is at 6.2%, a 60-year high.**

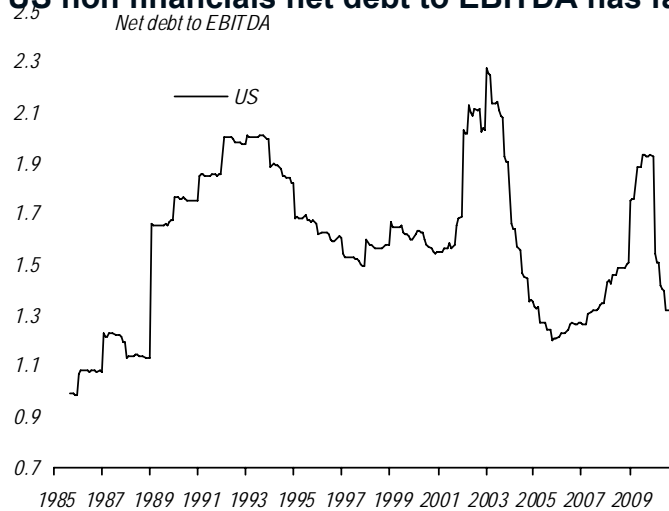
**Global non-fin corporate FCF, % of GDP**



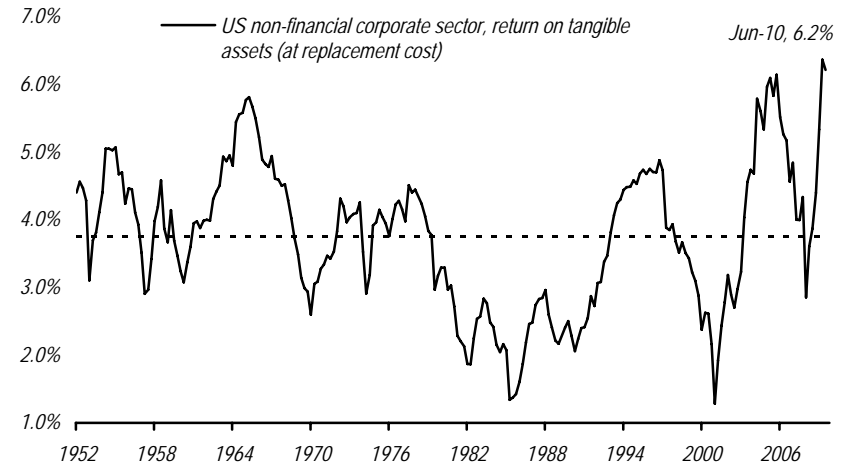
**Investment shares of GDP are at all-time lows in the G4**



**US non financials net debt to EBITDA has fallen**

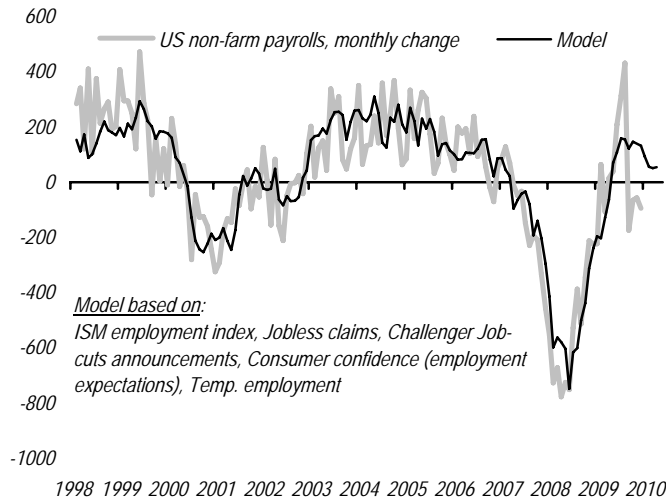


**And it has never been so profitable to invest**



**Our US employment model is consistent with a c1% rise in employment (80k monthly payroll gain). Temporary employment growth, consumer employment expectations, announced layoffs and the ISM employment index are still supportive. And US corporates have overshed labour during the recession.**

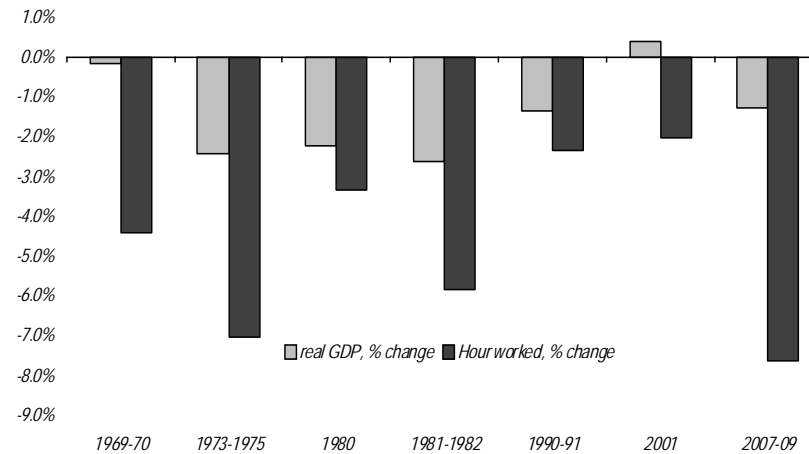
**Our US payrolls model suggests c80k monthly payrolls gain**



Model of monthly change in US non-farm payrolls				
Input variables (3m lead)	Coefficient	Last	Standardized	T-value
Temporary employment, 3m change	0.61	9.2	0.2	2.6
Consumer employment exp.	5.4	-6.6	-0.3	3.0
Jobless claims (4-w average)	-0.3	459	-1.0	-1.9
Job-cuts announcements	0.1	34.8	1.1	0.5
ISM employment, composite (no lead)	25.0	52.1	0.5	8.0
Intercept	-1107	Model estimate	% rise in empl.	172
R2	0.79	82	0.8%	

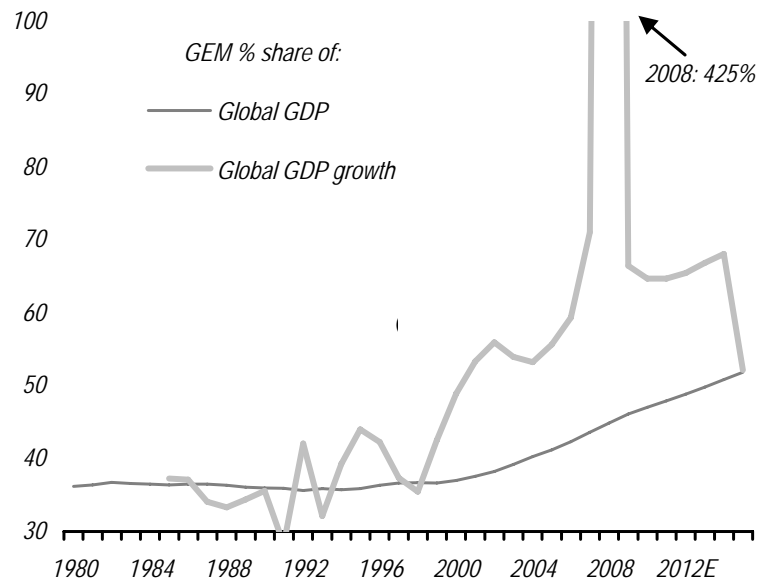
**US GDP and hours worked decline during recessions**

- since peak, hours worked is down 7.5%, employment by 5.5% while GDP is down 1.3%.

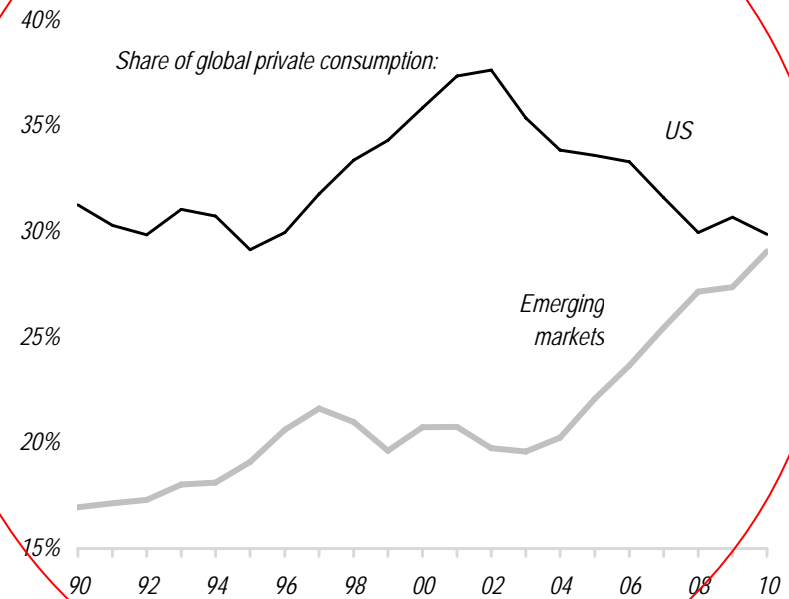


# The proportion of global GDP that comes from emerging markets is 48% and rising ...

**GEM share of global GDP is 48%**



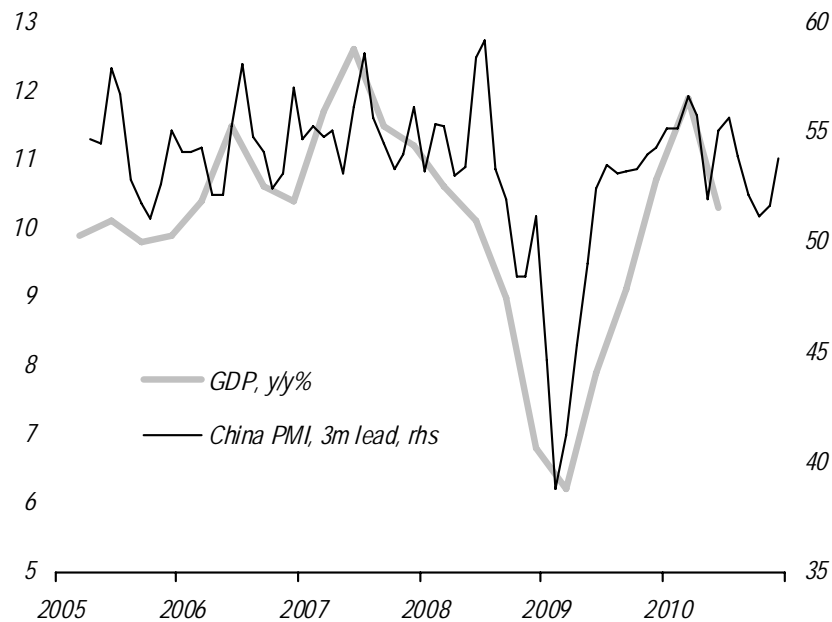
**GEM and US private consumption are now at similar levels- in USD terms**



...with China having a soft landing (CS forecast China GDP growth of 9.7% in 2010, 8.8% in 2011). Investment growth is decelerating but consumption growth is solid (minimum wages have been raised 22% this year – highest rate in 20 years).

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PMI is slowing but still consistent with 9%-10% GDP growth



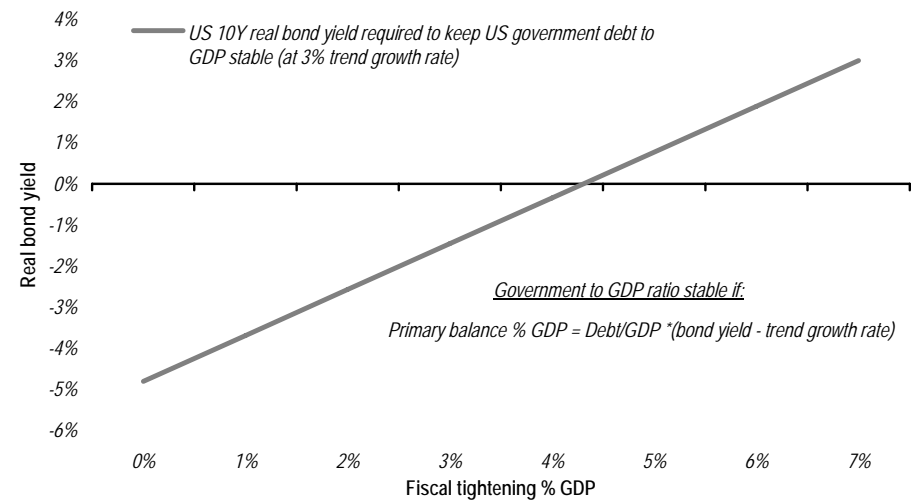
China real retail sales is at 15% yoy



# The power of zero rates ...How does QE 2 work.....4 ways.....

- a) **QE would drive down real bond yields.** Each 1% off the real bond yields would add 20% to the fair value of equities on our DCF models, 10% to house prices (to keep affordability stable) and 0.5% to consumption (by lowering the savings ratio by the same amount). Above all, a 1% fall in government bond yields would reduce the amount of tightening governments need to stabilise the government debt-to-GDP ratio by 0.9%. The fall in real bond yields over the last 2 years has nearly halved the amount of fiscal tightening the US need to do. Fed's Dudley says \$500bn QE equivalent to 0.5/0.75 rate cut (this would raise real GDP by 0.4% if we also assume the USD fall by 10%)
- b) **The funds flow effect:** \$300bn of QE over 3 months gives asset allocators a \$300bn of money to invest. It is noticeable that equities went up when QE started and then stopped going up when QE stopped.
- c) **It would force – via a weaker dollar - other central banks to participate in QE.** For if the yen/dollar went to 75, say, the Bank of Japan would be very likely to react with its own form of quantitative easing. Ultimately, the risk is that QE forces the Euro to become very overvalued to force ECB to do QE.
- d) **The psychological impact of low bond yields on governments:** the lower the level of government bond yields, the less governments would be 'forced' to tighten policy.

**Fiscal tightening needed to keep government debt to GDP stable (relative to real bond yield)**



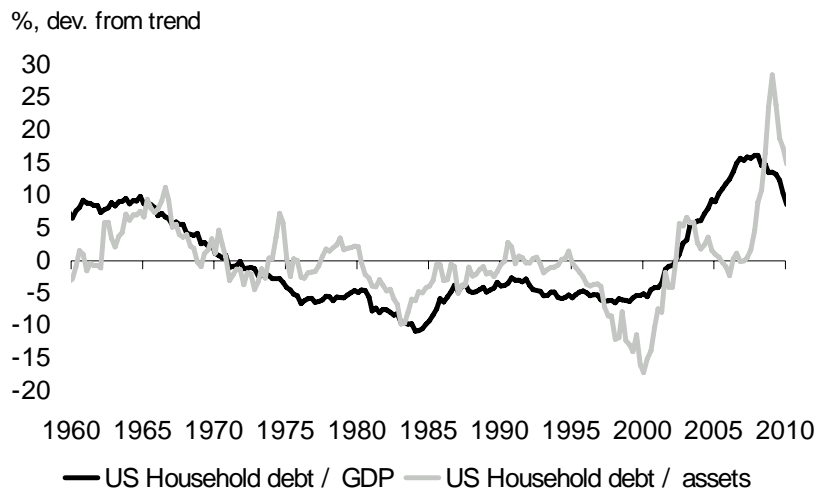
## ... But this is not like Japan in the 1990s.

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- Monetary and fiscal policy has been a lot more pre-emptive.
- Falling wages and negative inflation expectations are the definition of deflation and these both went negative early on in Japan (1997 and 1993). This is not happening in the US.
- Huge backdrop of asset deflation (80% fall in house prices in Tokyo!)
- Banking bail out has been a lot more pre-emptive (recaps started in 1998 in Japan)
- Corporates not allowed to fire workers, thus price of labour had to adjust.
- The household sector and Japan are creditors- thus benefit from deflation (unlike US) and therefore less political will to deal with deflation.

**SLOW/ORDERLY DE-LEVERAGING.** We estimate that the US consumer has about \$1.5trn of excess leverage but as LONG as house prices are stable and BOND YIELDS ARE LOW, our model suggests that the savings ratio should be at 4.8% compared to 5.8% now. A 5% savings ratio over 3 years would generate \$1.5trn of saving.

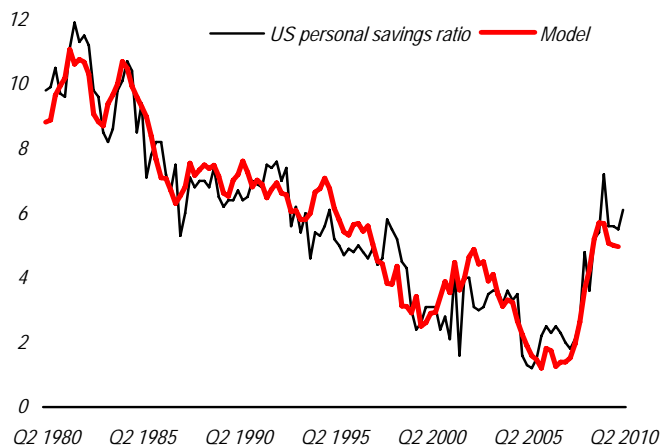
**US household leverage, % deviation from trend**



**5% savings ratio for 3.5 years or 6% for 3 years required to return HH liabilities/assets to trend**

US Household BS	3Q, \$trn	Scenario
Liabilities	13.9	12.0 Savings ratio 6% for 3y
Equity holdings*	10.8	10.8 Flat equity prices
Housing wealth	17.1	17.1 Flat house prices
Other assets	39.5	39.5
<b>Total assets</b>	<b>67.4</b>	<b>67.4</b>
HH liabilities/ assets	21%	18%
Trend	18%	18%
<b>Excess leverage</b>	<b>2.2</b>	<b>0.1</b>
memo: GDP \$14.1trn	14.6	

\*direct + indirect



**US savings ratio should be stable at around 4-5%**

Input Variables:	Coeff.	T-value	Current
US Net household wealth/DPI	-2.7	-12.5	4.7
US 10Y bond yield	0.4	10.3	2.4
Intercept	16.7	12.6	16.7
R2	0.91		
Standard error	0.83		
US savings ratio (model)			4.8
US savings ratio (latest)			5.8

Note:

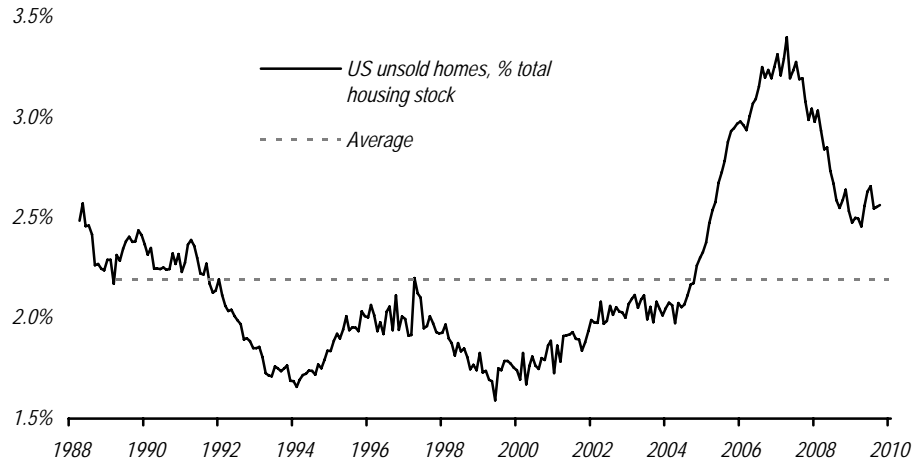
a 10% increase in house prices reduces the savings ratio by 0.5%

a 10% increase in stock prices reduces the savings ratio by 0.3%

a 1% rise in BY raises the savings ratio by 0.5%

**US Housing:** Volumes have collapsed post-end of tax credit but: a) The Shiller price index is up 4% yoy, in spite of record foreclosures; b) FHA – 35% of all home purchases- will continue to guarantee mortgages with LTVs of 96.5%. End of tax credit is only worth 5% of median house price; c) 70% of mortgages are now OWNED by the government!; d) house prices fall only when distressed sales are more than a third of the total (currently 32%, peak 50%); e) loans are being restructured (349k in Q1 vs. 189k in 4Q09, 3.1m loan modifications since April 2009). Starts are almost half of trend housing demand.

**US home inventories are 2.7% of the housing stock (average 2.2%)**

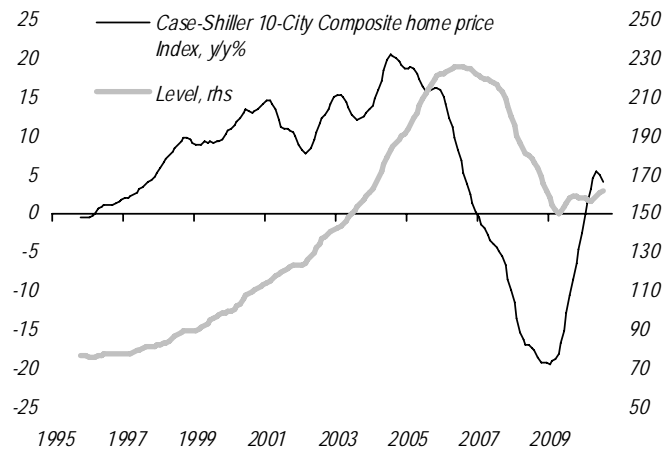


Estimate of US housing demand (million units)

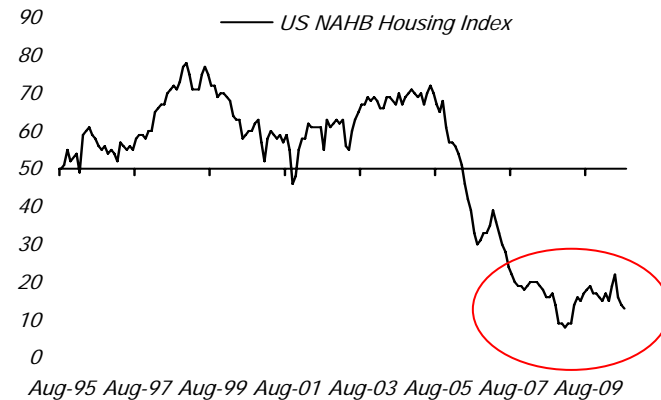
Household formation	1.31
Trend growth of vacant units	0.05
Net Removal of housing units	0.24
Underlying demand of housing units	1.60
Placements of mobile homes	0.14
Underlying numbers of completions	1.46
Units started but not completed	0.06
Underlying numbers of housing starts	1.52
Current level of housing starts	0.55
Net demand	0.97
Net supply from unsold homes	1.72
Net supply from foreclosed properties*	1.02
<b>Excess housing inventory</b>	<b>2.7</b>
Years required to absorb excess inventory	2.8

\*50% of housing units in foreclosure process

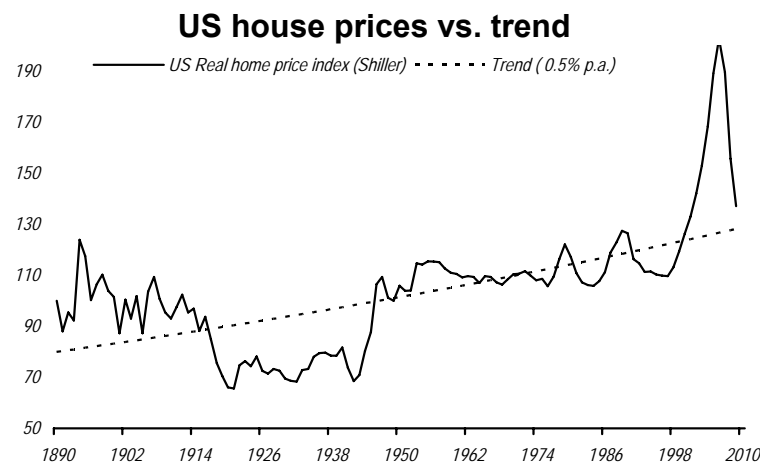
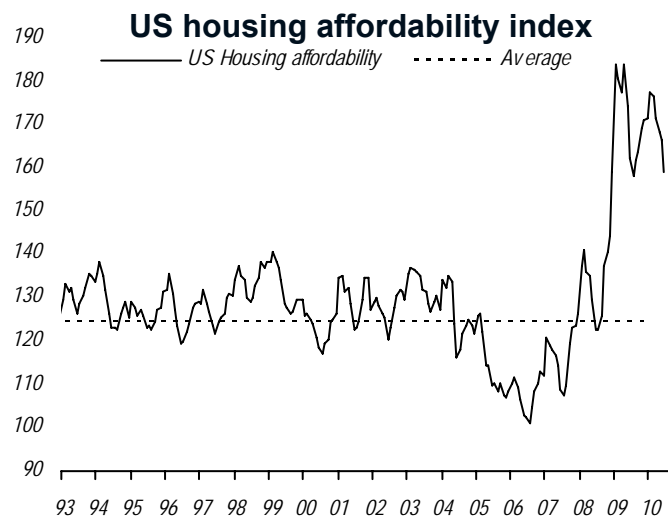
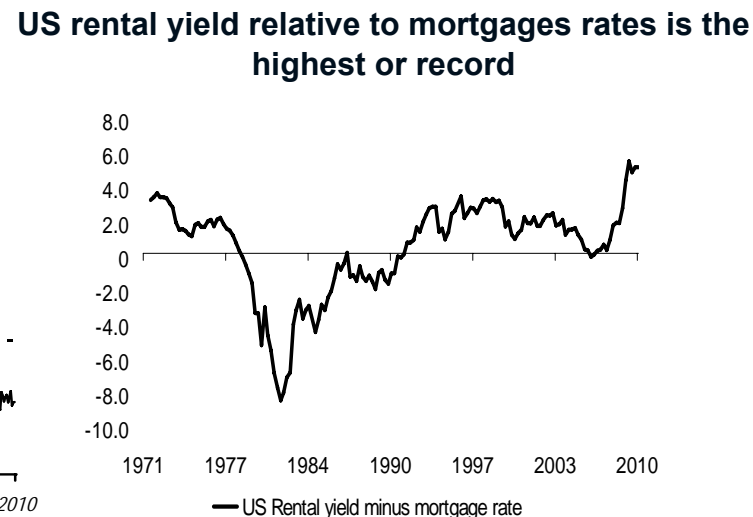
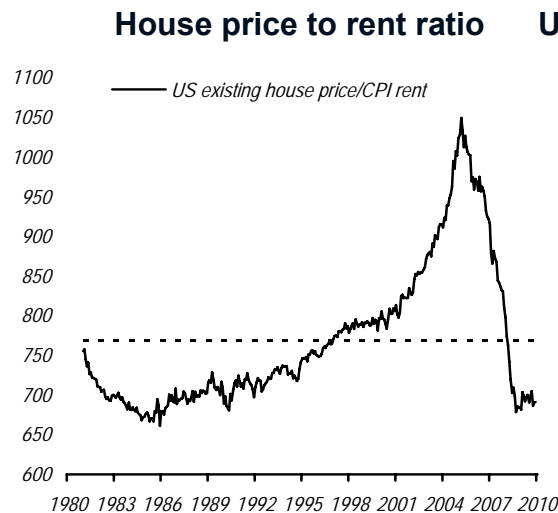
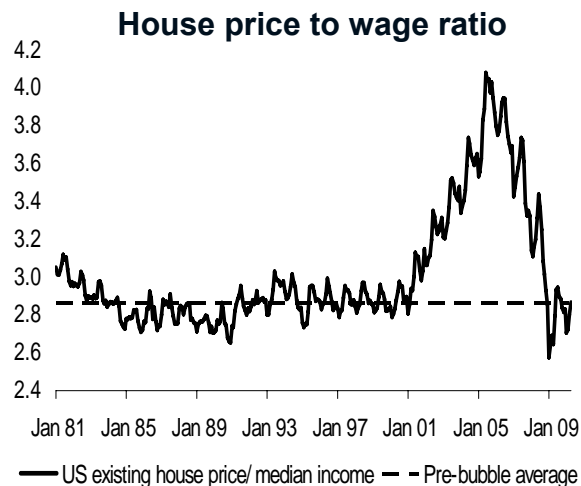
**House prices are still rising at 4% yoy**



**NAHB forming a low**



**Housing is clearly cheap on most measures ... The house price to income ratio is close to previous trough levels, house price to rent ratio is 4% above the all-time low and the rental yield is the highest on record relative to the mortgage rate. As a consequence, housing affordability is very high**



## Asset Allocation: 1,220 S&P 500 year-end and 1250 mid-year (our US strategist Doug Cliggott is much more cautious)

- 1) Valuations are cheap: equity risk premium on post-1900 trend earning is 5.2%. On Consensus numbers ERP is 6.7% (target is 4.6%). Equities better hedge against the risks we are concerned about (inflation/sovereign credit) than bonds. Market looks to be discounting about 10% decline in earnings. Gap between FCF yield and corporate bond yield is at an all time high.
- 2) Margins are very high but RoE is not as asset turns and leverage have scope to increase. Margins set to remain very high until labour has pricing power.
- 3) CDX spreads back at levels 1300 S&P 500 and now credit spreads now back to OK levels.
- 4) Positioning. Investors are overweight bonds versus equities.
- 5) Our tactical indicators: a slight Tactical warning but this does not alter our positive strategic view on equities

Global asset allocation table

	Benchmark	Recommended weight	OW (+) UW (-)	Change
Equities	60	65	5	0
Government bonds	25	24	-1	-1
Corporate bonds	5	3	-2	-2
Cash	10	8	-2	3
Total	100	100	0	0

# The difficult phase for markets when ISM and earnings revisions roll-over..... On the last two occasions this happened, equities fell sharply but on average equities are flat.



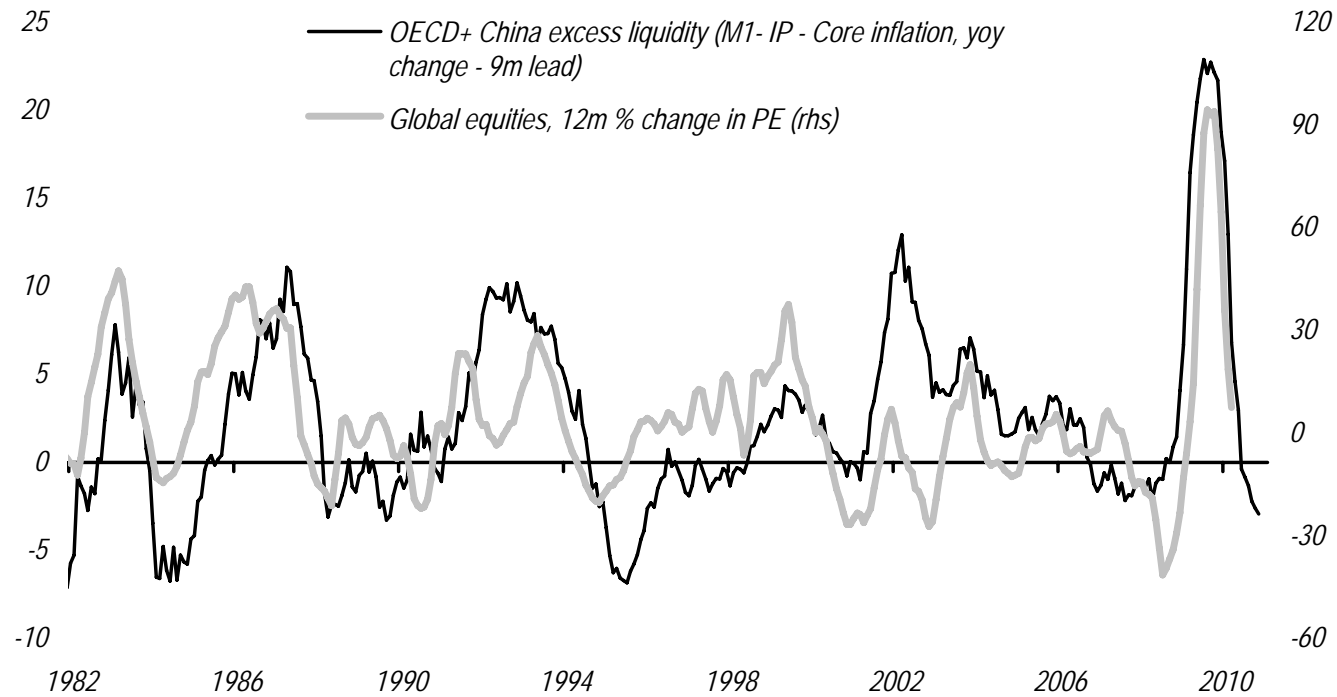
**Equities roughly flat when earnings revisions are negative and ISM rolls over, but on the last two occasions this happened, equities fell sharply**

Periods when earnings revision were negative and ISM rolled over

Date	Performance of S&P after				
	1m	2m	3m	6m	12m
Sep-91	2%	0%	0%	6%	11%
Mar-92	2%	3%	1%	3%	12%
Jun-97	8%	2%	8%	8%	28%
Mar-02	-2%	-5%	-11%	-25%	-24%
Jun-07	1%	-6%	-4%	-6%	-12%
<b>Average</b>	<b>2%</b>	<b>-1%</b>	<b>-1%</b>	<b>-3%</b>	<b>3%</b>
Median	2%	0%	0%	3%	11%
% outperform	80%	40%	60%	60%	60%

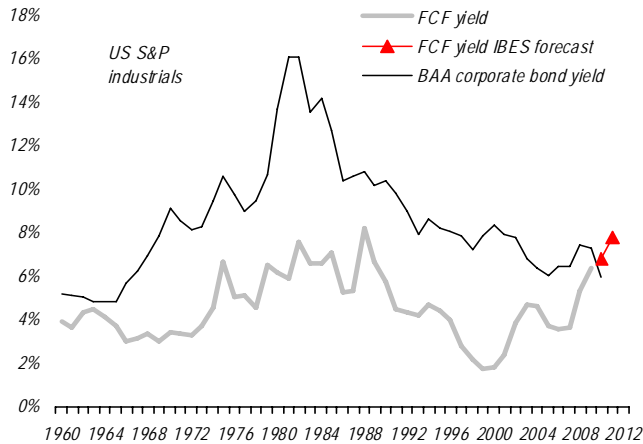
# .... Excess liquidity has fallen a lot but is still consistent with a rise in the markets over the next 6 months.

Global excess liquidity is becoming less supportive for equities

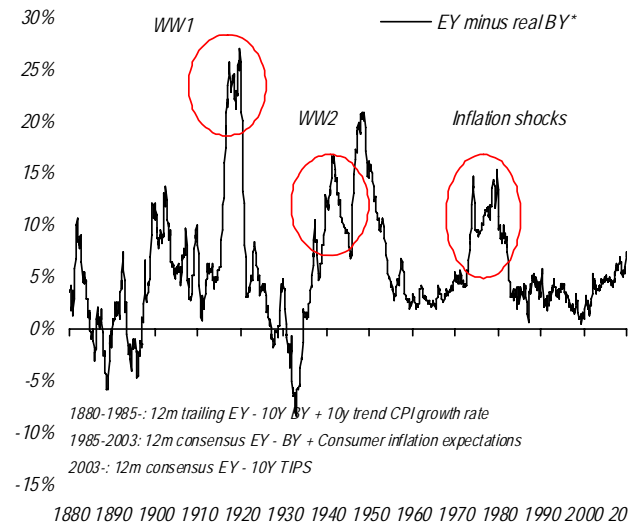


**Valuation of equities is clearly cheap against bonds. The gap between the FCF yield and the corporate bond yield is at an all-time high. Equities are cheaper against index-linked bonds than even in 2009. Equities have underperformed bonds for 30.5 years – longest period for almost 80 years**

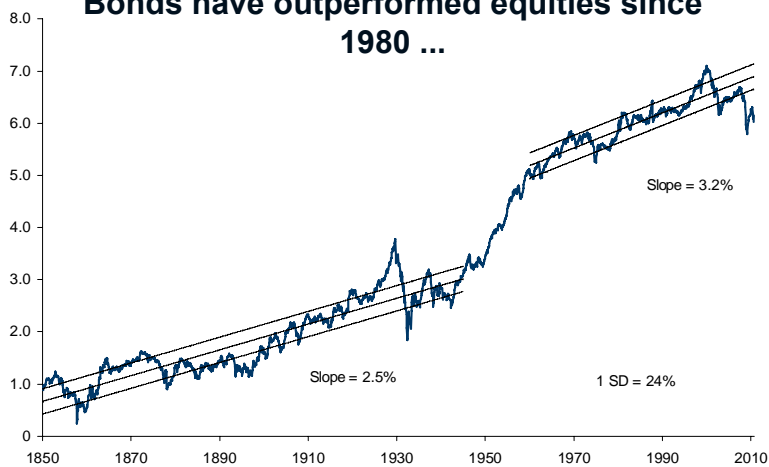
**The gap between FCFY and corporate bond yield has never been higher**



**The 12m consensus EY is the highest relative to real bond yields since 1955 – excluding the high-inflation period of the 1970s**



**Bonds have outperformed equities since 1980 ...**



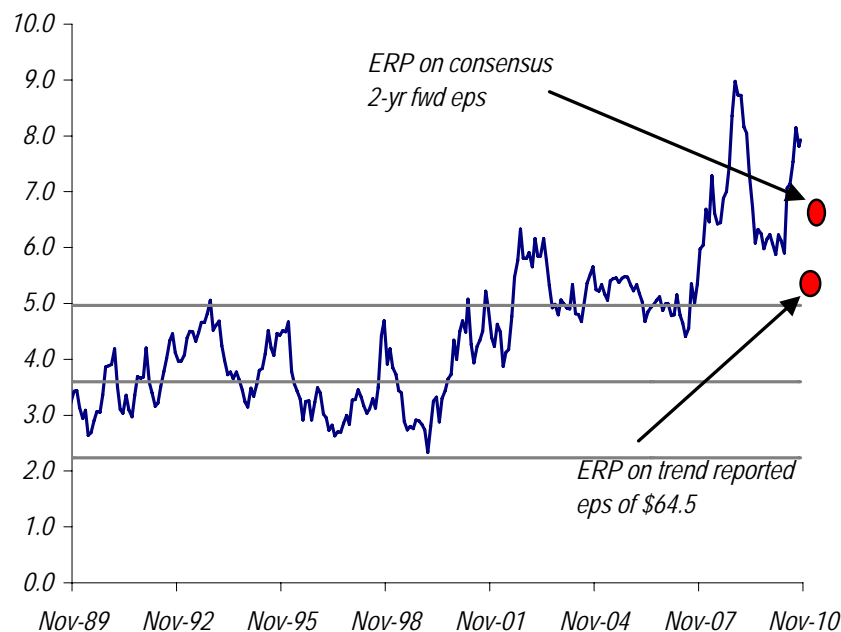
**... such a long period of outperformance is very unusual**

Longest period of US equities underperformance relative to US bonds			Performance of Bonds relative to equities 30.5 years after bonds started outperforming equities		
Start	End	Years	1y	5y	10y
Feb-1980	Aug-2010	30.5			
Aug-1929	Feb-1951	21.5			
Apr-1901	Jun-1932	31.2	20%	-15%	0.3%
Nov-1852	May-1897	44.5	13%	13%	-18%

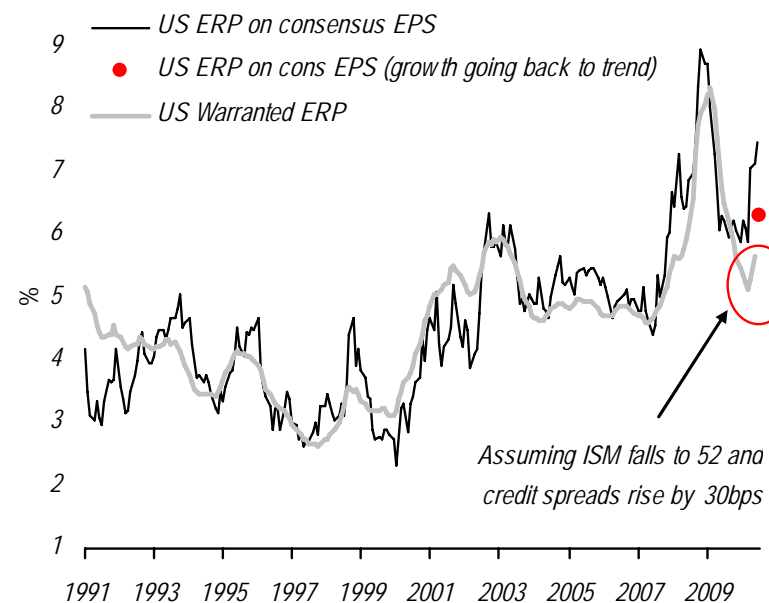
**We find the ERP on IBES estimates is very high at 7.9%.  
 If we apply our core scenario (2-year forward IBES numbers and then applying trend growth) it is 6.7% compared to our target of 4.6%**

US ERP	12mth fwd EPS	12-24mth fwd EPS growth	3-5yr fwd EPS growth	Equity risk premium
Consensus EPS estimates	\$92.7	14.1%	11.0%	7.9%
Consensus 12mth fwd EPS and 12-24 mth fwd EPS growth	\$92.7	14.1%	6.4%	6.7%
Trend reported EPS of \$64	\$64.5	6.4%	6.4%	5.2%
Historical average equity risk premium				3.6%

**The equity risk premium**

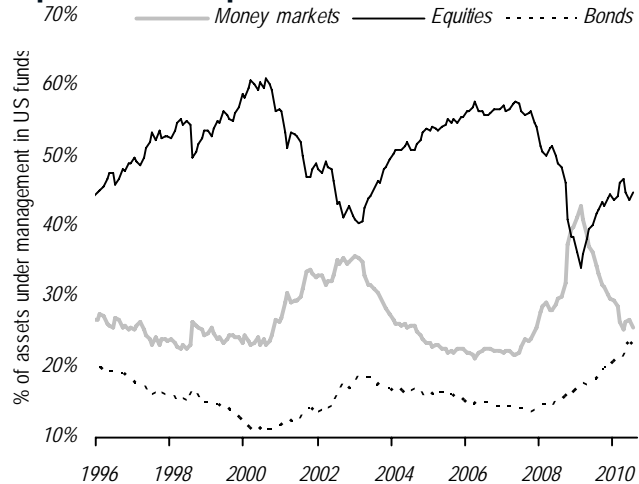


**The equity risk premium**

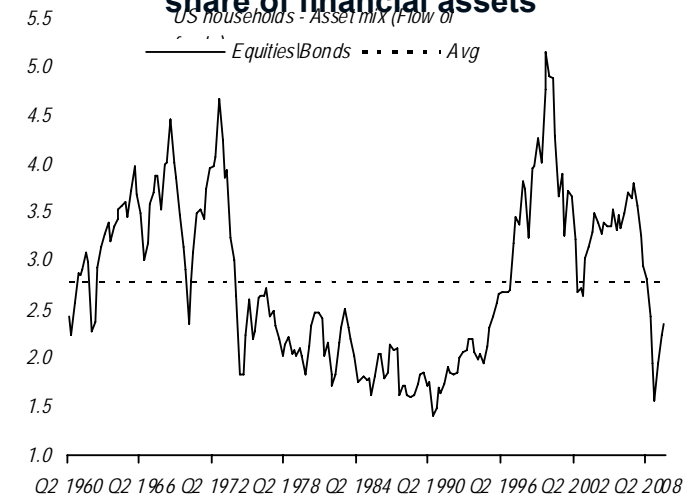


**Allocation: investors are still underweight equities, according to our data. As a consequence of the weak flow, we think investors are now mis-positioned, i.e., underweight equities. Only 45% of US mutual fund assets are now invested in equities, compared to a 15-year average of 51%. Bond funds, on the other hand, account for 23% of mutual fund net assets, the highest level since 1996**

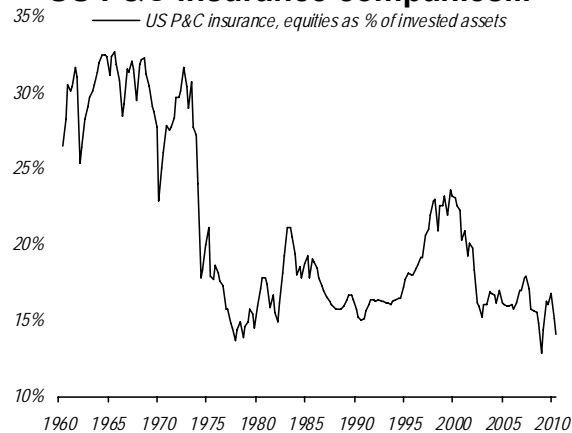
**Only 45% of mutual fund assets are invested in equities—compared to 51% since mid-1996**



**US households—equities relative to bonds in share of financial assets**



**Equity weightings are close to historical lows for US P&C insurance companies...**



**... and for UK pension funds**



**Bond yields are likely to move slightly higher from current levels. Yet, we do not see a major sell off (50bp or more)- bond yields will stay low for longer**

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**We expect bond yields to move a bit higher from here as:**

- US bonds yields are about 50bp below fair value on our models;
- Even in periods of serious deflation, we have not seen bond yields considerably below current levels;
- Bonds look overbought (inflows into bond mutual funds are 3 standard deviations above average);
- Economic momentum has troughed in our view; and
- There is a record gap between lead indicators and bond yields in both the US and Europe.

**However, bond yields are likely to stay low for longer as:**

- The Fed is fully committed to QE (see latest FOMC statement);
- Bond yields almost never trough before a trough in the ISM;
- The policy rate should be even lower (-2.3% on the Taylor rule);
- Negative or zero real rates are required to offset the announced fiscal tightening (1% of GDP globally next year);
- Core inflation not likely to trough before the end of 2011;
- Banks are still increasing their holdings of government securities (13% of total assets compared to a peak of 20% in 1994).
- We believe that bonds are not in a bubble: over the last 6 months, the performance of US bonds have been almost 2 standard deviations above average - this is far less than the c6 standard deviations seen in previous bubbles (gold in the 1970s, Japan equities in the 80s, tech stocks in the 90s and commodities between 2003 and 2006).

## Macro themes.....

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- M and A set to pick up.....
- Buy pricing power.....
- Be careful of the government.....
- BRIC consumer ...
- QE

## 1) M&A: We expect to see a sharp recovery in global M&A and buybacks:

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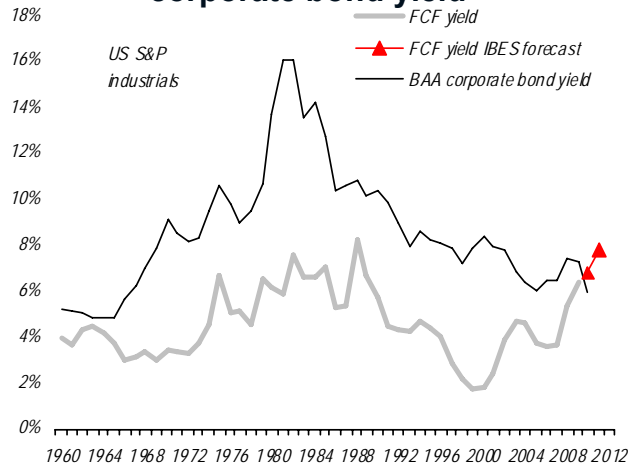
We expect to see a sharp recovery in global M&A and buybacks as:

- **Valuations are compelling**— there is a record gap between FCF yield and corporate bond yield. 25% of the European market trades below 1.1x replacement value, implying it is as cheap to buy as to build.
- **Corporate leverage is back to average levels.** Just over 50% of US and UK markets have net debt to EBITDA (last reported) below 1x and corporate cash positions are close to record highs.
- **Corporates do intend to spend** according to CEO business confidence or Credit Suisse's proprietary survey of corporates (Corporate spend: underpinned but understood, 22 July), where 50% of corporates said they intend to increase M&A.
- **M&A tends to lag the stock market and the economic cycle by 12 months**, thus a pick-up is overdue. M&A activity is close to all-time lows as a percentage of market cap and GDP. Share buybacks could also rise (0.15% of market cap in July, compared with 0.22% average) should pick up. Taxation also now favours buybacks (relative to dividends) in most countries

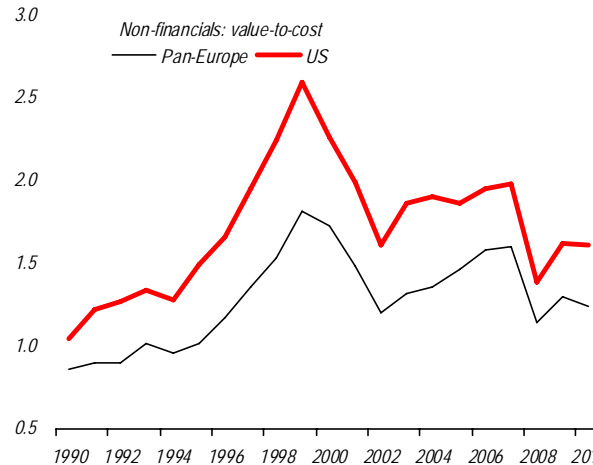
We have set up a Delta One basket to play the M&A theme: Bloomberg code CSERTARG Index

**FCF yield at a 50-year high against the corporate bond yield and 83% of the US and 63% of European corporates have net debt-to-EBITDA below 2X. We calculate that if companies with a net debt-to-EBITDA below 2X were to re-lever to that level, they would need to buy 19% of market cap in the US and 22% in Europe**

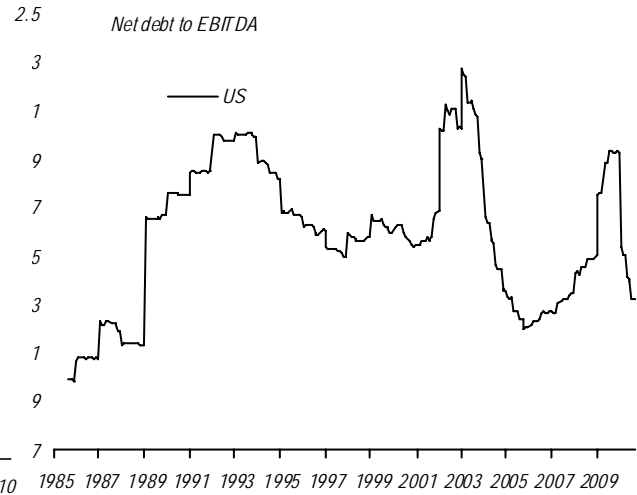
**The FCFY is at a 50-year high vs the corporate bond yield**



**Non-financials' VCRs are below historical averages in both Europe and the US**



**... and corporate leverage is quite low**

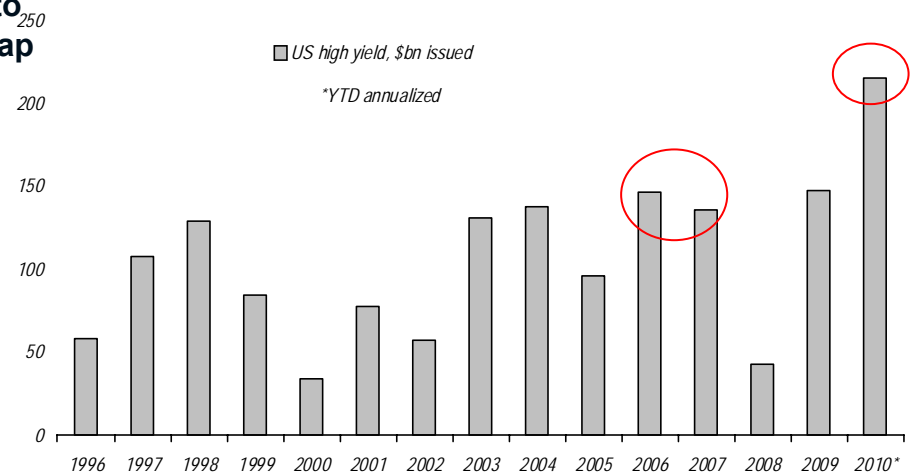


**If European corporates with net debt-to-EBITDA below 2x were to re-lever to that level, they would buy around 20% of the market cap**

*Market cap that needs to be bought to relevel to 2X net debt to EBITDA*

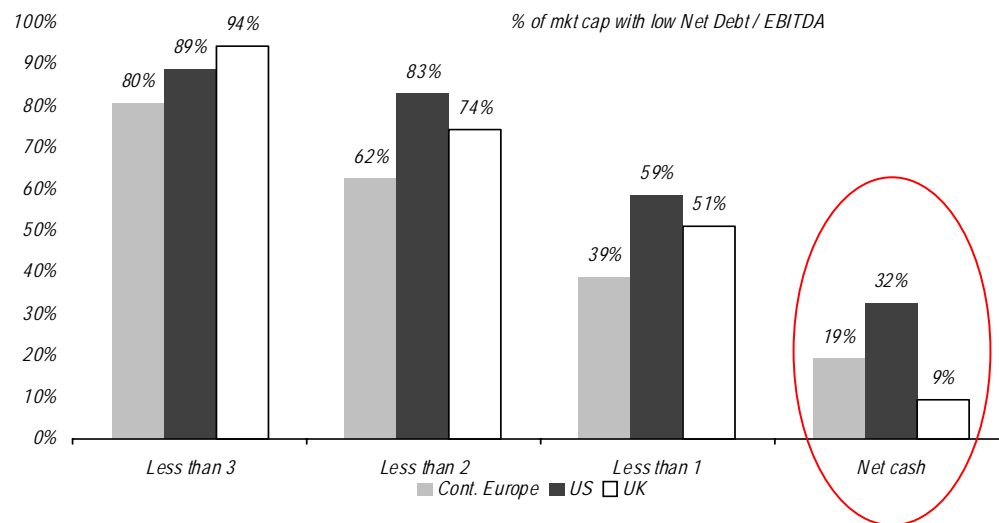
Non-financial corporate sector	US	Europe	US	Europe
	If companies with net debt/ebitda <2X relevel to that level		If market aggregate net debt/ebitda rises to 2X	
% companies with net debt/Ebitda <2X	83%	63%		
Underleverage (\$bn)	1,685	1,412	1,033	183
% market cap	19%	22%	10%	3%

**US high yield issuance at a record high this year**

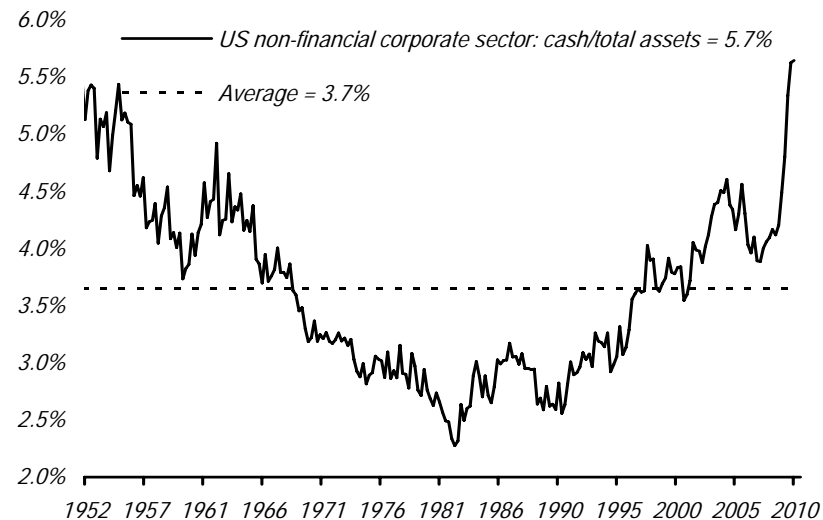


# Lots of stocks are underleveraged, cash on balance sheet is an all-time high and almost a third of the US companies have net cash position

High proportion of companies with net cash

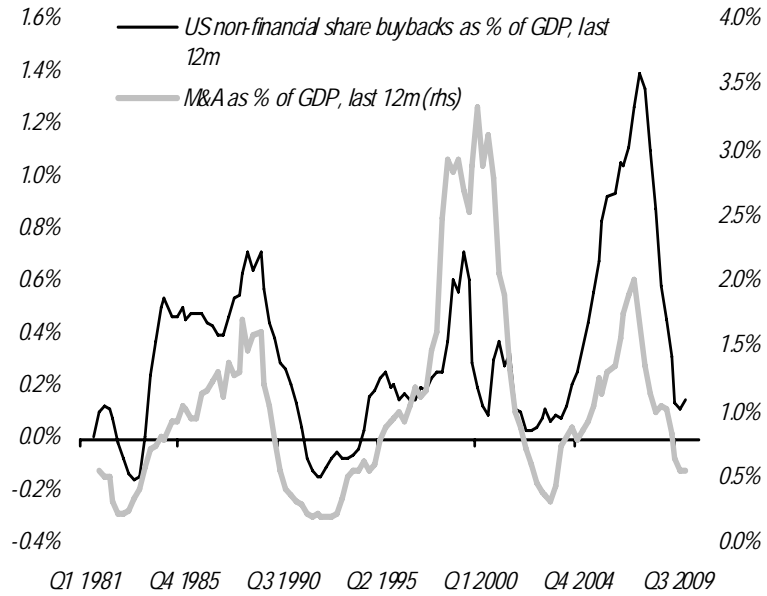


Cash on balance sheets is abnormally high... 5.7% of total assets in the US

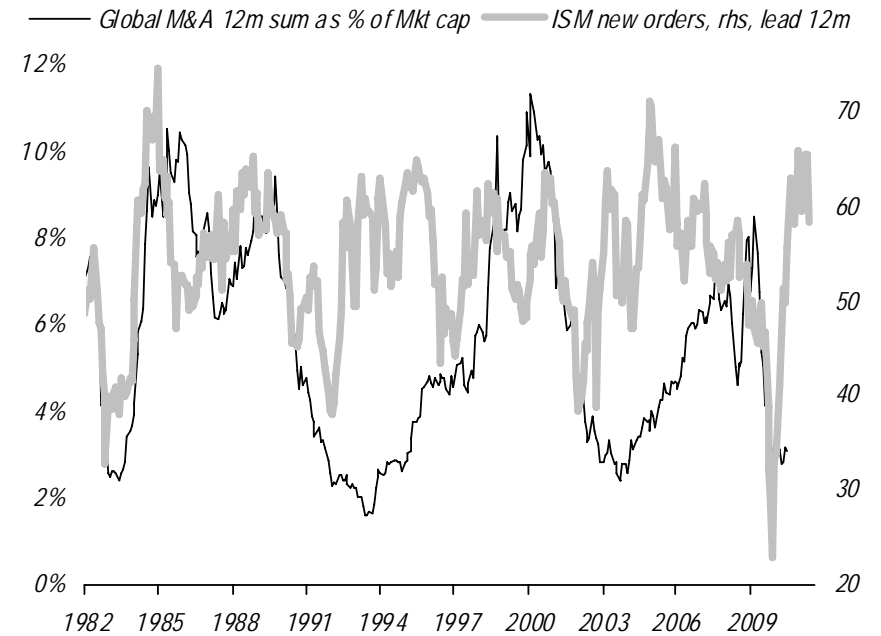


# M&A lags the cycle by 12 months

M&A and buybacks are very low and well correlated



... and lags the business cycle by one year



**What areas are most likely to see M&A? We rank sectors by looking for: a high gap between FCF yield and corporate bond yield; low leverage; attractive valuations on price to replacement cost; and low earnings volatility**

**Pan European M&A scorecard – positive gap between the FCF yield and the corporate bond yield, low leverage, low value-to-cost ratio and low earnings volatility**

Pan Europe sectors M&A scorecard					
Sector	FCFY less BY	Net Debt to EBITDA	Value to Cost Ratio	Earnings volatility	Total score
Pharma	6.8%	0.6	1.5	1.9	5.1
Tech H/W	4.3%	-1.2	1.1	1.0	3.2
Telecoms	6.1%	2.3	1.1	0.9	2.1
Retail	2.2%	0.3	1.9	2.6	1.9
Fd Prods	3.5%	1.1	2.2	2.2	1.6
Semis	3.1%	-1.0	1.1	0.4	1.1
Media	4.2%	1.7	2.2	1.7	1.1
Cap Goods	2.8%	1.5	1.4	1.8	0.9
Hotels & Lei	1.4%	2.1	1.3	2.8	0.7
CommI Svs	1.8%	1.4	2.6	2.9	0.6
Cons Dur & App	1.3%	0.4	1.8	1.8	0.0
Food Rtl	-0.8%	1.5	1.4	3.2	-0.1
S/W & Svs	2.0%	-0.6	2.7	1.3	-0.2
Met & Min	2.1%	1.4	1.2	1.0	-0.6
Healthcare	2.1%	2.0	2.5	1.8	-1.0
Beverages	2.8%	3.1	3.3	2.4	-1.1
H/H & Per Prod	2.0%	0.5	3.7	1.6	-1.5
Autos	3.0%	5.0	0.7	1.3	-1.5
Energy	-1.2%	0.7	1.0	1.5	-2.0
Transport	-0.3%	2.9	1.1	1.8	-2.4
Tobacco	3.9%	2.4	5.4	1.5	-2.8
Utilities	-3.8%	2.9	0.9	1.8	-5.3
Market	2.3%	1.9	1.2	1.9	

*Note: All the parameters are ranked on z-score. Earnings volatility is the average divided by standard deviation of last 15 years sector EPS. High FCFY less BY is positive, low Net debt to EBITDA, low VCR and low earnings volatility are positives.*

## 2) Buy pricing power! In Europe, this highlights paper, luxury goods, mining.

### Sectors with the best pricing power in Europe ...

Euro-area sector pricing scorecard	YoY%			Rank
	Current	Z-score	6m change	
Paper	12.0%	2.77	14.1%	1
Metals&Mining	8.6%	1.36	9.1%	2
Luxury goods	11.4%	1.78	4.9%	3
Chemicals	5.8%	0.73	3.0%	4
Energy Utilities	3.1%	-0.41	10.6%	5
Airlines	1.3%	-0.40	5.1%	6
Energy	13.9%	0.44	-4.4%	7
Tech Hardware	-2.4%	2.16	3.7%	8
Food Producers	1.0%	-0.08	2.8%	9
Insurance	3.0%	0.04	0.2%	10
Food & Drug Retailing	1.1%	-0.48	2.2%	11
Water	3.0%	0.26	-0.6%	12
Banks	1.3%	-0.61	0.3%	13
Capital Goods	0.9%	-0.64	0.6%	14
Tobacco	3.3%	-0.70	-1.0%	15
Auto producers	0.2%	-0.86	0.7%	16
Retailing	0.2%	-0.70	0.4%	17
Hotels/Rest./Leisure	1.3%	-1.76	0.3%	18
Travel	-0.6%	-0.97	1.0%	19
Telecom	-0.9%	0.02	-0.6%	20
Health Care	-0.6%	-0.50	-0.2%	21
Media	-0.7%	-1.15	0.4%	22
HH Prod.	0.8%	-1.18	0.0%	23
Consumer durables	-0.2%	-1.50	0.1%	24

### ... and in the US

US sector pricing scorecard	YoY%			Rank
	Current	Z-score	6m change	
Paper	6.5%	2.01	5.3%	1
Airlines	8.7%	0.97	3.3%	2
Metals&Mining	18.2%	0.65	3.5%	3
Tobacco	7.5%	0.93	3.1%	4
Hotels/Rest./Leisure	3.5%	0.55	8.3%	5
Luxury goods	3.6%	0.67	4.0%	6
Travel	2.3%	0.71	3.8%	7
Food Producers	5.1%	0.48	2.5%	8
Water	7.0%	1.12	-1.0%	9
Tech Hardware	-4.5%	1.86	5.1%	10
Utilities	2.7%	-0.27	8.3%	11
Banks	3.3%	0.43	1.6%	12
Chemicals	5.1%	0.17	0.5%	13
Auto producers	2.3%	1.70	-1.2%	14
Energy	7.8%	0.07	-9.1%	15
Health Care	3.8%	0.23	-1.1%	16
Insurance	1.5%	0.12	-0.2%	17
Consumer durables	0.7%	-0.66	1.2%	18
Capital Goods	0.2%	-0.25	0.0%	19
Food & Drug Retailing	1.0%	-1.13	1.1%	20
Telecom	-0.1%	-0.30	-0.5%	21
Media	-0.6%	-1.78	0.2%	22
HH Prod.	-0.7%	-1.04	-0.4%	23
Retailing	-2.5%	-0.60	-0.8%	24
Software	-9.3%	-1.41	-6.7%	25

### 3) Be careful of expensive government exposure (where margins are high).

#### Underperform or Neutral rated stocks with significant government exposure

Name	Govt exposure(%)	ROE	EBITDA Margin (2010e)	-----P/E (12m fwd) -----			----- P/B -----		Yield (2010e)		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		
Qinetiq Group	100%	15.3	10%	7.9	73%	-32%	1.5	-23%	15.9%	1.3%	28.2	-2.5	1.8	-23.1	Neutral
Safran	80%	-23.0	12%	12.7	117%	16%	1.9	-4%	7.1%	2.3%	44.2	5.6	0.5	20.0	Neutral
Cobham	78%	22.6	21%	9.9	91%	6%	2.5	24%	12.4%	2.9%	120.4	-1.1	-0.8	-18.2	Neutral
Ultra Electronic	47%	34.6	16%	14.5	133%	34%	6.2	22%	8.5%	2.1%	114.0	0.0	-0.1	0.0	Underperform
Rhoen-Klinikum Ag	90%	9.3	12%	14.9	143%	17%	1.7	-17%	-3.3%	1.8%	-26.7	-1.0	0.2	53.9	Neutral
Celesio Ag	80%	6.9	3%	9.0	86%	-25%	1.1	-42%	9.1%	3.1%	17.7	-9.0	0.3	-36.0	Neutral
Stada Arzneimittel	70%	11.7	18%	11.2	113%	-11%	1.6	-5%	6.3%	2.6%	-4.6	-4.7	-1.7	0.0	Underperform
Befimmo Sca	60%	2.7	83%	12.8	n/a	n/a	1.0	n/a	n/m	6.6%	-28.1	1.6	0.0	-100.0	Underperform
Medica	50%	-10.9	17%	17.2	164%	n/a	5.6	n/a	n/a	0.9%	n/a	-1.8	0.1	77.8	Neutral
Hochtief Ag	45%	9.4	6%	14.3	118%	-18%	1.5	-5%	4.9%	3.2%	-16.7	-0.2	0.5	47.4	Underperform
Astrazeneca	45%	41.6	42%	7.7	78%	-36%	2.3	-46%	14.5%	5.0%	75.0	4.4	0.8	-18.0	Neutral
Alstria Office Rei	40%	-3.1	81%	16.7	n/a	n/a	0.7	n/a	n/m	5.2%	-35.3	4.7	-5.8	42.9	Neutral
Acs Actividades Co	36%	27.6	10%	11.0	90%	44%	2.3	6%	1.7%	5.6%	-22.5	0.9	-1.1	-44.4	Underperform
Fom Const Y Contra	35%	12.9	12%	8.0	66%	-10%	1.0	-50%	7.2%	7.1%	-44.3	-4.4	-4.2	-41.2	Underperform
Logica Plc	33%	11.1	9%	8.5	72%	-28%	0.9	-45%	16.2%	3.6%	-0.4	-0.1	-0.8	10.3	Neutral
Cofinimmo Sa	25%	6.2	88%	12.4	n/a	18%	0.8	23%	n/m	6.6%	-35.6	0.8	-1.4	-75.0	Underperform
Sodexo	20%	16.4	7%	15.2	95%	12%	2.9	26%	5.0%	3.0%	-15.6	3.1	1.7	-40.0	Neutral
Hikma Pharmaceutic	20%	11.6	24%	19.6	198%	37%	2.2	-9%	2.7%	1.0%	-28.0	8.1	0.7	20.0	Neutral
Tieto Oyj	16%	23.1	11%	10.1	86%	n/a	1.8	n/a	8.8%	4.2%	31.5	-12.8	-0.2	-14.3	Underperform
Hays	15%	47.8	4%	18.8	n/a	75%	10.9	-4%	1.9%	6.4%	-77.9	1.7	1.5	-44.0	Neutral

## 4) How to play QE 2?

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### What to buy?

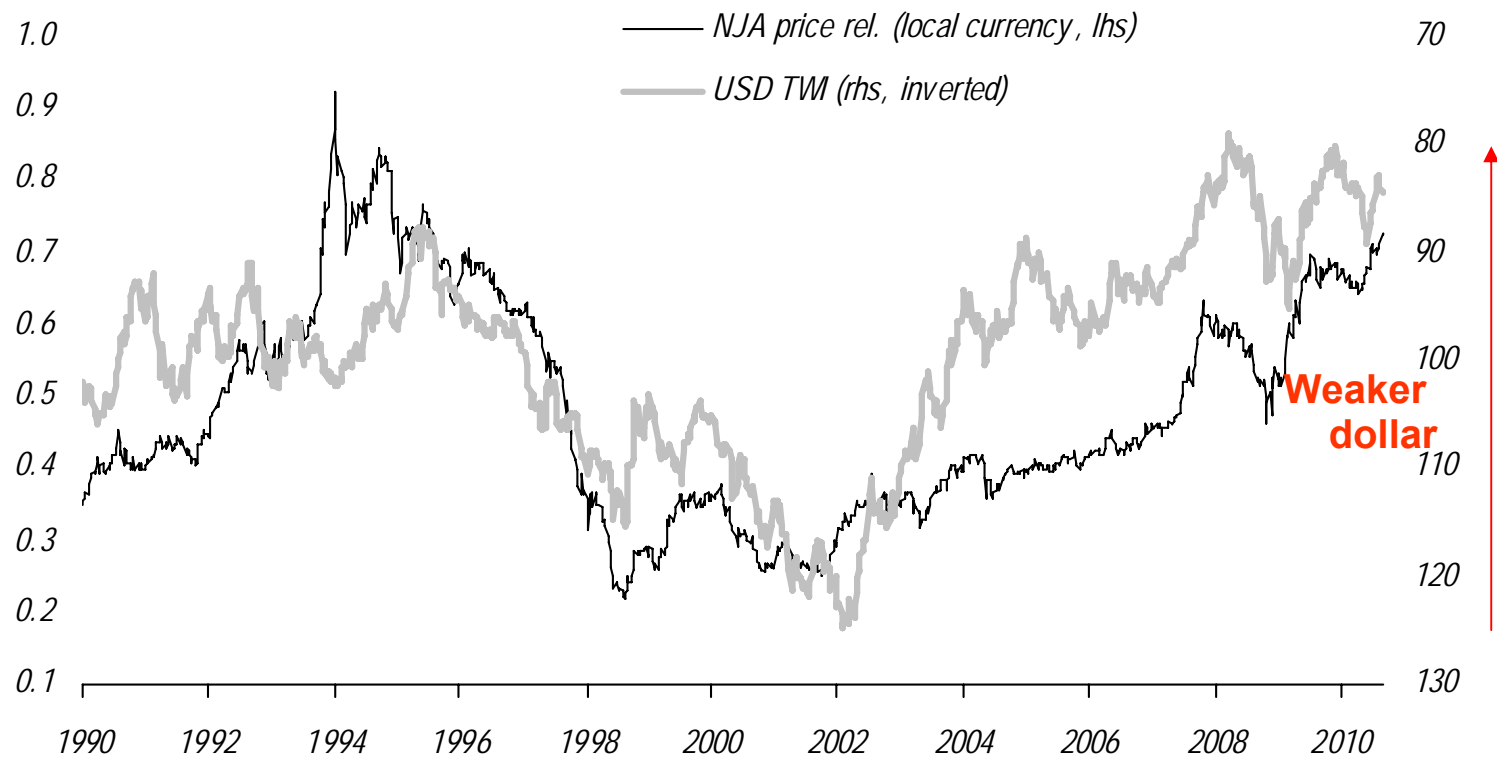
- (1) **NJA. (i) Domestic (especially HK) and (ii) indirect NJA plays in Europe and US**
- (2) **Regulated utilities with a CPI link**
- (3) **Gold**
- (4) **Growth stocks**
- (5) **High DY with DPS growth stocks**
- (6) **High leverage**

### What to avoid?

- (i) **Companies or sectors that have longer duration liabilities than assets (this includes life insurance companies).**
- (ii) **Companies with high unfunded pension liabilities.**

**Focus on:** (1) Buy domestic Non Japan Asia plays, especially Hong Kong (they will import a looser monetary policy via the dollar-link). We think that if QE 2 occurs, the dollar would weaken. There is a close (negative) correlation between dollar weakness and NJA relative performance

NJA tends to outperform when the dollar weakens (local currency terms)



(ii) Indirect plays on NJA. 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 HOLT® or have a FCF yield above 5% are: Swatch, Millennium & Copthorne, HSBC, WPP, Danone. In the US cheap on HOLT® are Qualcomm, Motorola, Nike, Cisco, Pepsico

### European stocks with high exposure to the NJA consumer

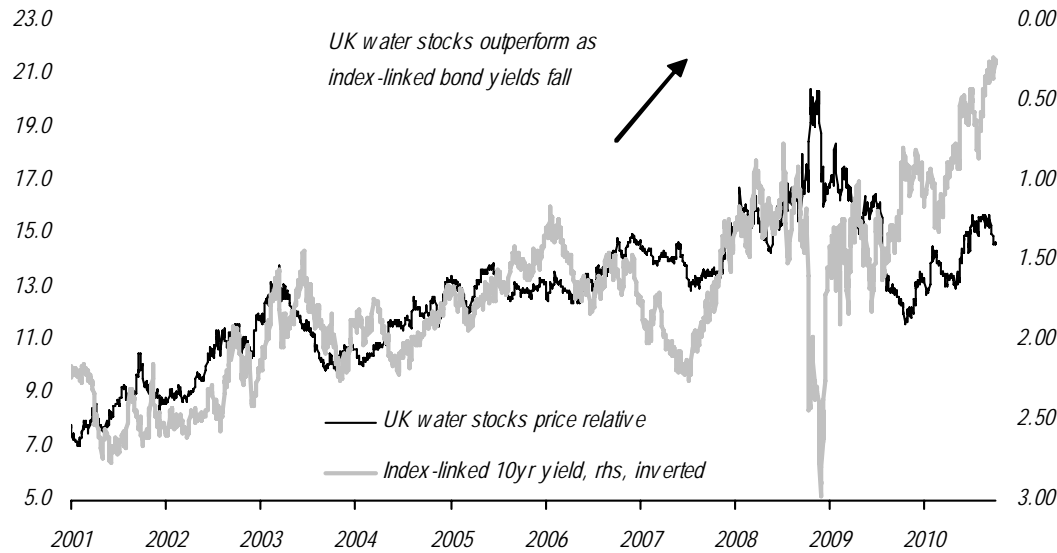
Name	% Sales from NJA	% Sales from China	-----P/E (12m fwd) -----			----- P/B -----		Yield (2010e)		HOLT	Momentum		Consensus (buy less holds & sells)	Credit Suisse rating
			Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Price, % change to best	3m EPS	3m Sales		
Standard Chartered	75%	22%	13.3	124%	55%	1.3	-23%	n/m	2.4%	-16.8	3.1	-3.8	-15.4	Outperform
Prudential	60%	n/a	6.5	68%	-34%	2.2	-46%	n/m	3.4%	-18.7	25.6	-20.5	30.4	Outperform
Swatch Group	34%	27%	17.0	94%	60%	3.4	65%	5.0%	1.5%	-21.1	8.6	4.2	3.7	Outperform
Remy Cointreau	33%	31%	19.1	126%	39%	2.3	77%	4.5%	2.9%	-52.8	1.0	2.4	-10.0	Outperform
Millennium&Copthne	33%	3%	17.7	104%	35%	0.9	52%	4.6%	1.5%	16.0	15.9	3.1	25.0	Outperform
Richemont(Cie Fin)	32%	20%	18.2	101%	75%	4.7	132%	4.8%	1.2%	-25.1	7.2	6.6	21.4	Outperform
Hsbc Hldgs	27%	17%	10.8	101%	22%	0.9	-46%	n/m	3.5%	11.9	13.2	0.8	30.8	Outperform
Volkswagen Ag	17%	16%	n/a	n/a	n/a	1.0	-14%	5.9%	n/a	50.2	n/a	@NA	n/a	Outperform
Sabmiller	16%	9%	16.3	107%	45%	1.6	-5%	4.8%	2.3%	-25.3	2.1	1.1	-40.7	Outperform
Wpp Plc	11%	5%	12.3	90%	22%	1.5	8%	9.6%	2.4%	-8.7	4.1	1.0	40.0	Outperform
Danone	10%	4%	14.7	100%	16%	1.8	-20%	5.6%	2.9%	-9.5	2.8	2.2	0.0	Outperform
Beiersdorf Ag	10%	3%	18.8	100%	7%	3.8	1%	4.9%	2.0%	-8.1	1.0	0.9	-33.3	Outperform

### US stocks with high exposure to the NJA consumer

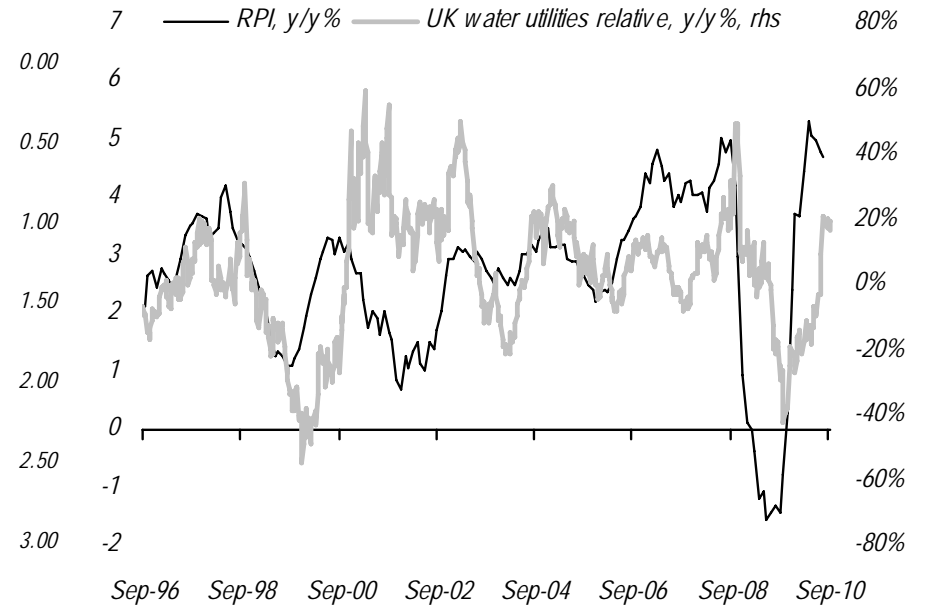
Name	% Sales from NJA	% Sales from China	-----P/E (12m fwd) -----			----- P/B -----		Yield (2010e)		HOLT	Momentum		Consensus (buy less holds & sells)	Credit Suisse rating
			Abs	rel to Industry	rel to mkt % above/below average	Abs	rel to mkt % above/below average	FCY	DY	Price, % change to best	3m EPS	3m Sales		
Qualcomm Inc	68%	21%	17.5	128%	-29%	3.6	-2%	5.6%	1.6%	28.8	2.1	1.5	40.0	Neutral
Yum Brands Inc	32%	21%	17.0	100%	37%	18.9	154%	5.9%	1.9%	-22.5	0.3	0.6	5.3	Outperform
Philip Morris	17%	0%	13.6	106%	n/a	25.3	n/a	6.6%	4.3%	-21.8	-0.1	0.5	50.0	Outperform
Tiffany & Co	16%	5%	15.9	110%	14%	3.0	13%	5.8%	1.9%	-20.9	0.6	-0.7	36.8	NR
Motorola Inc	16%	7%	16.5	120%	1%	2.0	-7%	7.1%	0.0%	10.1	6.6	1.8	9.1	Outperform
Nike Inc	14%	9%	17.4	97%	46%	3.9	25%	4.9%	1.5%	1.2	-0.6	0.8	30.0	Outperform
Cisco Systems Inc	10%	n/a	12.3	90%	-33%	2.9	-46%	8.0%	0.0%	32.4	0.2	0.0	48.9	Outperform
Pepsico Inc	10%	5%	14.5	96%	-2%	5.3	3%	0.3%	2.9%	12.7	0.2	0.9	62.5	Outperform

**We like REGULATED utilities: Their performance lagged the fall in real bond yields, regulated utilities like inflation rising (RPI has troughed) and the regulatory review has just finished**

**UK index-linked bond yields and water utilities are negatively correlated**

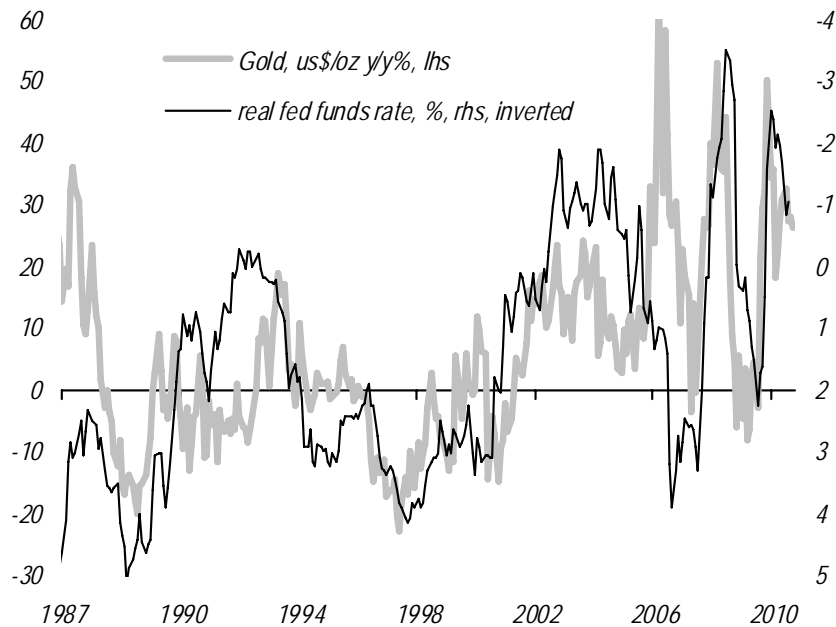


**UK water utilities relative performance is positively correlated with inflation**

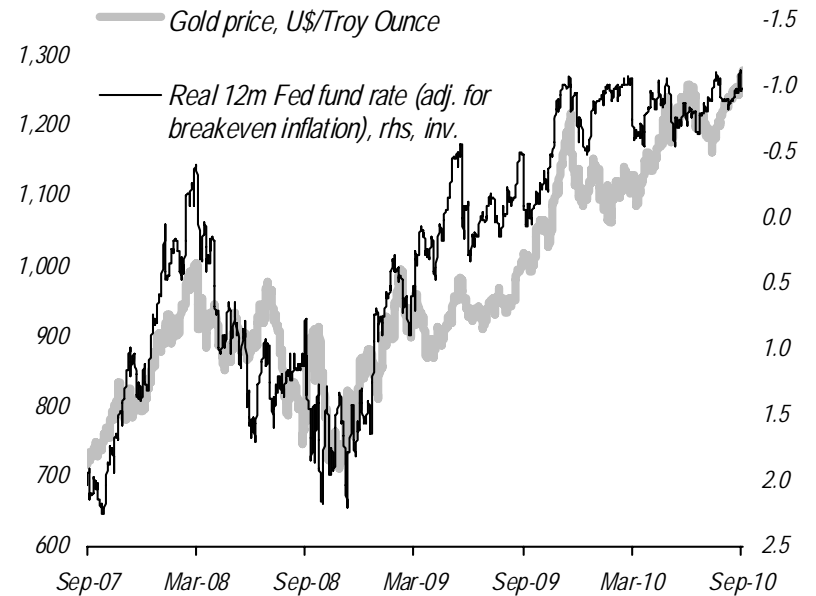


**GOLD:** We believe that the most important driver of the gold price is the real Fed Funds rate. Historically, when the inflation-adjusted Fed Funds rate has been below 2%, the gold price has tended to rise. We think the real Fed Funds rate will stay below 2% until at least 2013-2014

Gold is negatively correlated with real short rates ...  
in the long term ...

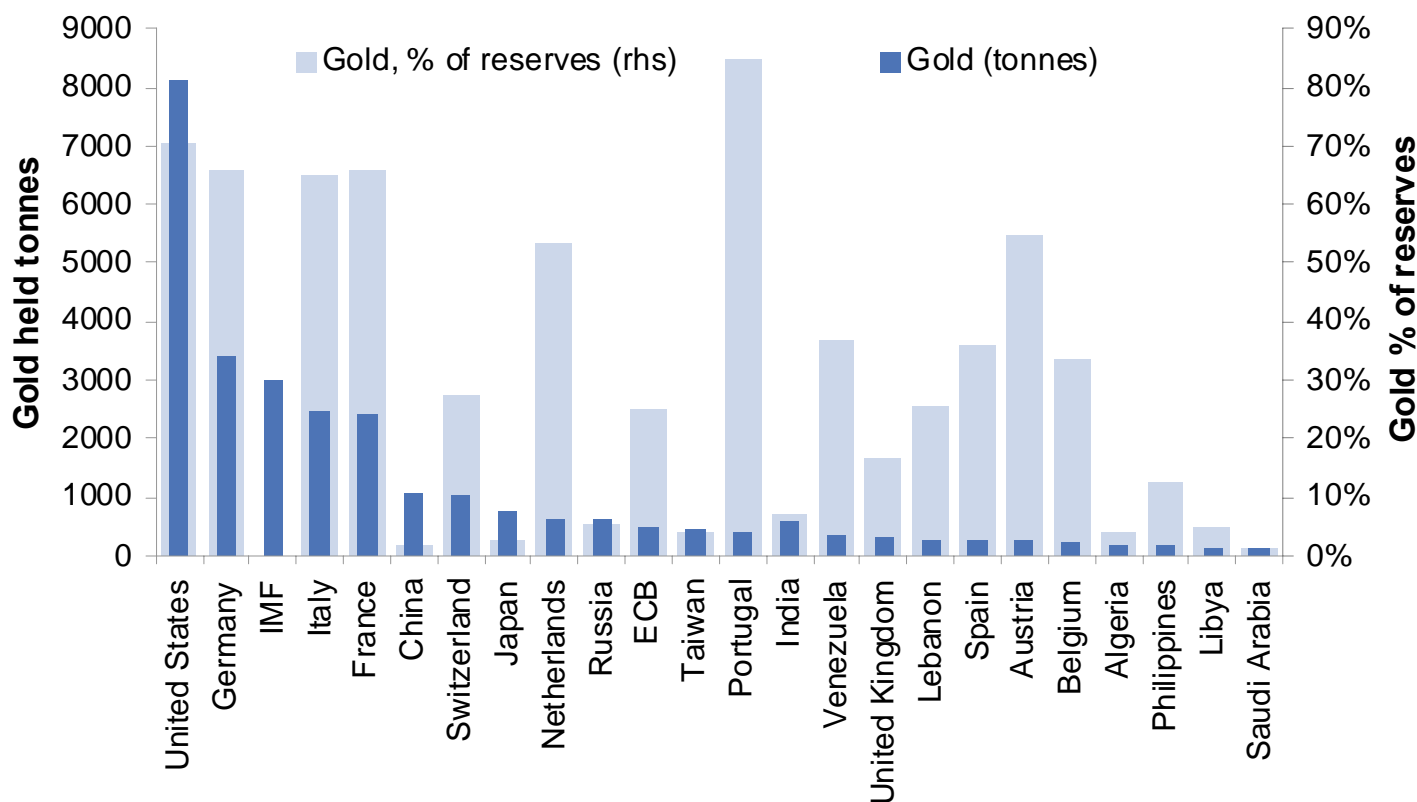


...and in the short-term



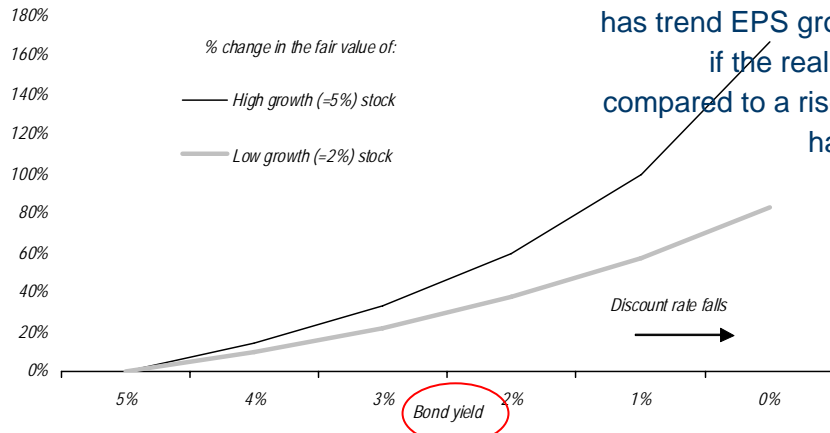
**Central banks under-own gold. If central banks in Japan and China had 10% of their reserves in gold (compared with only 2% currently), they would buy 3.5 times annual gold mine production. (Currently the US and Germany hold 70% and 66% of their reserves in gold, respectively)**

**China and Japan hold about 2% of their reserves in gold – compared with 70% of United States**

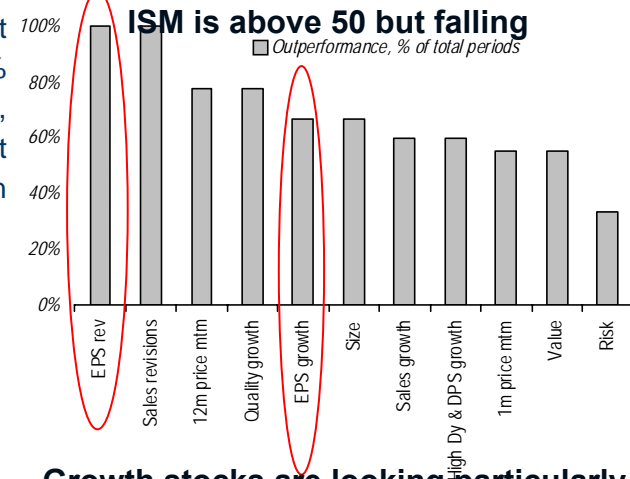


**Styles: Growth stocks.** The lower the discount rate, the more longer-term earnings are worth. This suggests we should be buying growth. Growth (12-month forward EPS growth) is a style that outperforms when ISM rolls over (but is above 50). Also this style has a zero beta to the market. Growth stocks are looking particularly cheap

Growth stocks have more upside if the discount rate falls



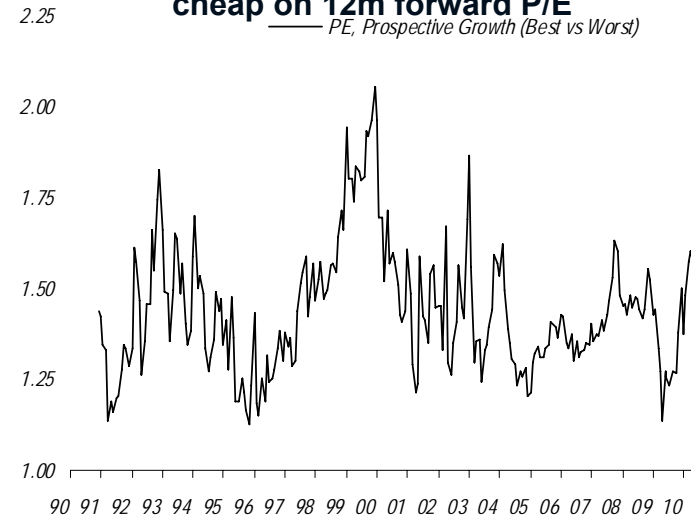
Proportion of the time a style outperforms when the



... and the growth style has a zero correlation to the market



Growth stocks are looking particularly cheap on 12m forward P/E



**The following stocks are among those that screen as having cheap cyclical growth with positive earnings revisions: BMW, Philips. In the US, it highlights Cummins and Union Pacific, among others**

**Credit Suisse Outperform and Neutral-rated European stocks with earnings growth and earnings revisions better than the market that trade on a P/E discount to their industry**

Name	EPS Growth			Earnings revision 2010e		Earnings breadth 2010e		Price to Earnings		CS Rating
	2010e	2011e	Long Term	1 month	3 month	1 month	3 month	2010e	rel to Indust	
Aegon	400%	17%	70%	13%	15%	0%	2%	6.5	79%	Neutral
Bmw (Xet)	1126%	26%	100%	38%	76%	21%	43%	10.4	84%	Outperform
Carlsberg 'B'	26%	16%	18%	9%	11%	19%	16%	14.1	94%	Neutral
Fresenius	17%	15%	14%	4%	4%	15%	3%	14.0	84%	Outperform
Heineken	20%	14%	12%	2%	2%	33%	20%	13.6	91%	Neutral
Metso	18%	31%	11%	23%	28%	15%	11%	13.2	99%	Outperform
Philips Eltn.Koninklijke	132%	19%	37%	6%	9%	7%	20%	11.8	88%	Outperform
Saint Gobain	108%	34%	34%	2%	3%	4%	-4%	10.2	77%	Outperform
<b>Market median</b>	<b>10.1%</b>	<b>14.3%</b>	<b>8.9%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>1.6%</b>			

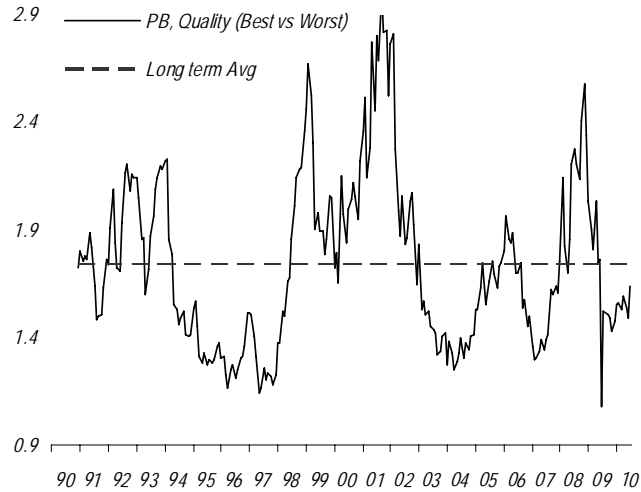
**Credit Suisse Outperform and Neutral-rated US stocks with earnings growth and earnings revisions better than the market that trade on a P/E discount to their industry**

Name	EPS Growth			Earnings revision 2010e		Earnings breadth 2010e		Price to Earnings		CS Rating
	2010e	2011e	Long Term	1 month	3 month	1 month	3 month	2010e	rel to Industry	
Csx	35%	15%	11%	4%	3%	4.0%	44.2%	12.9	78%	Outperform
Cummins	96%	29%	12%	31%	22%	6.3%	12.5%	14.2	99%	Outperform
Metropcs Comms.	37%	31%	22%	44%	30%	8.0%	9.1%	11.8	67%	Neutral
Union Pacific	44%	16%	14%	12%	3%	4.2%	23.2%	13.6	82%	Outperform
<b>Market median</b>	<b>12.6%</b>	<b>13.2%</b>	<b>10.6%</b>	<b>3.8%</b>	<b>-6.0%</b>	<b>0.0%</b>	<b>0.0%</b>			

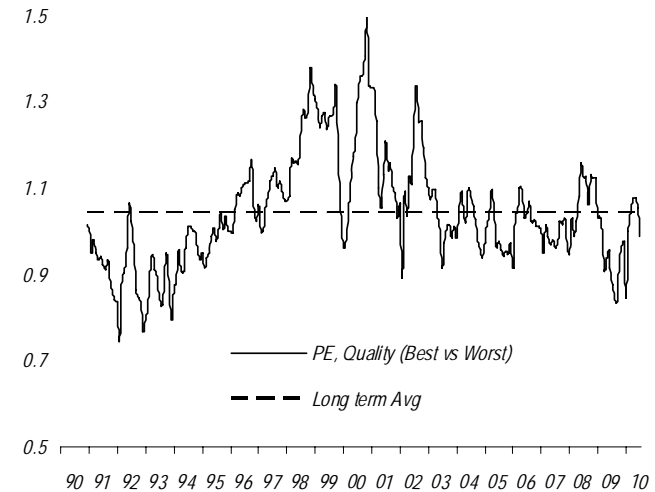
# Quality remains attractively valued on P/B and DY; d) quality is the best performing growth style in the long-run

The P/E and P/B relative of the best quintile relative to the worst quintile is 5% and 6% below average respectively.

Quality growth style P/B relative



Quality growth style P/E relative

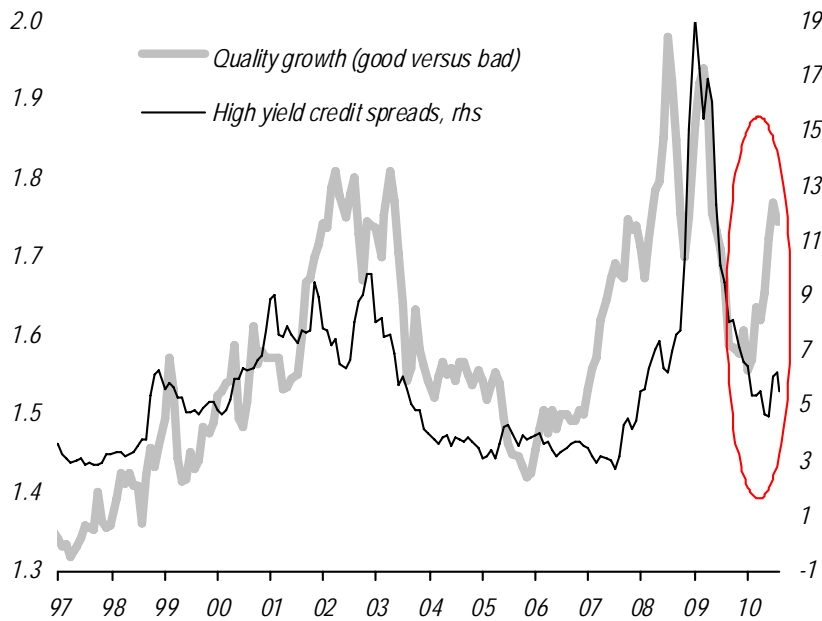


Quality growth is the best-performing growth style in the long-run

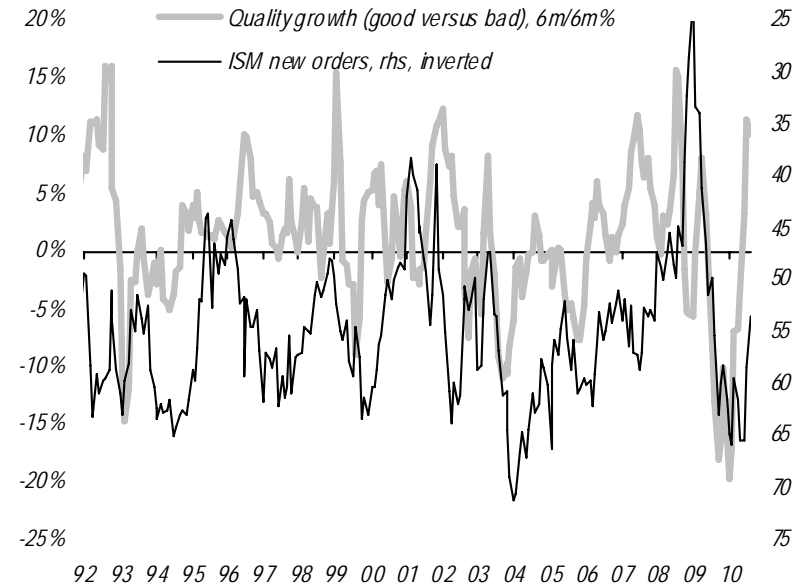


# A reminder of why we like quality growth: a) Quality growth likely to outperform when lead indicators peak and credit spreads stop falling

Quality growth tends to outperform when credit spreads stop narrowing

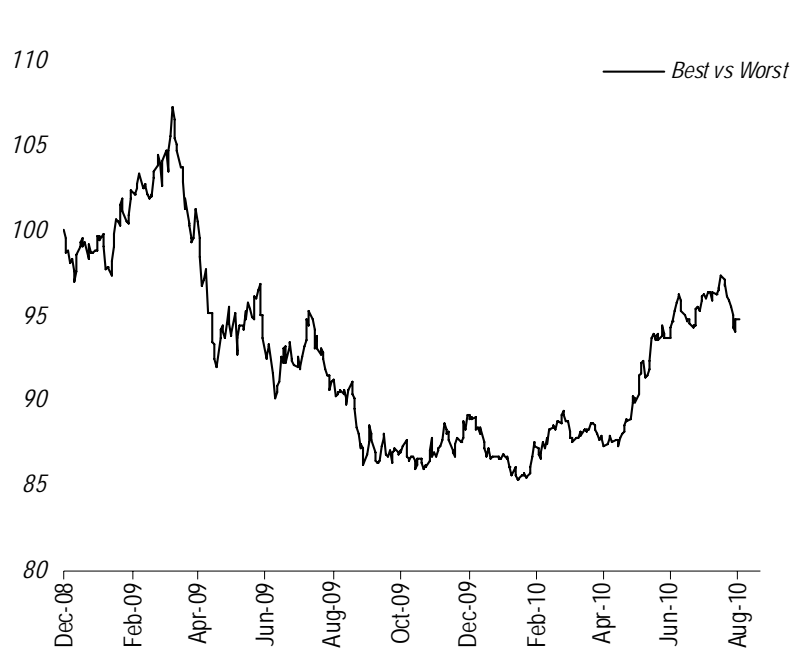


Quality growth tends to outperform as lead indicators peak and then fall

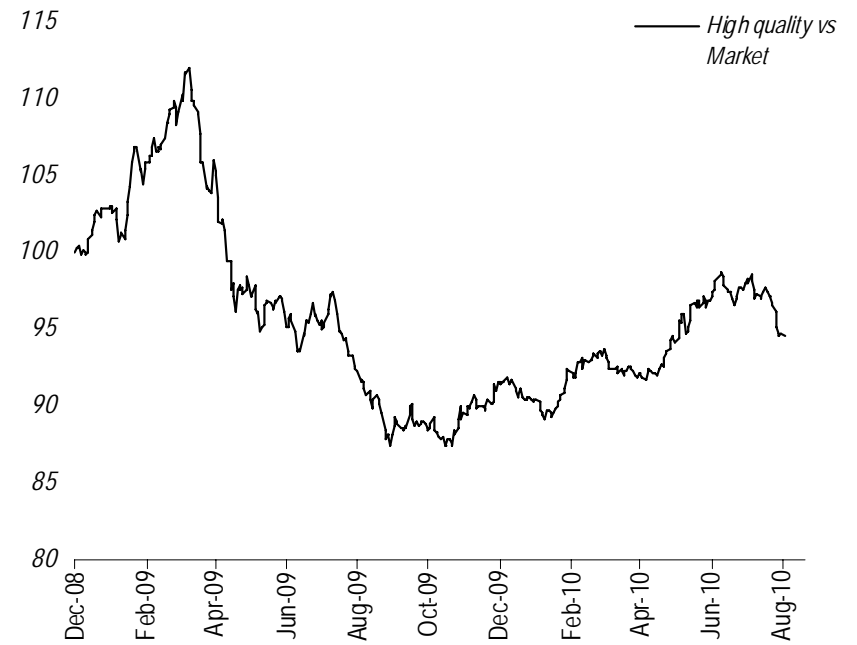


## b) Recent performance: quality growth quintile (superior historical and prospective earnings growth and superior asset turns) has outperformed both the market and the worst quintile YTD

The best quality growth quintile outperformed the worst quintile by 13% YTD



Quality growth stocks are gradually outperforming the market (13% YTD)



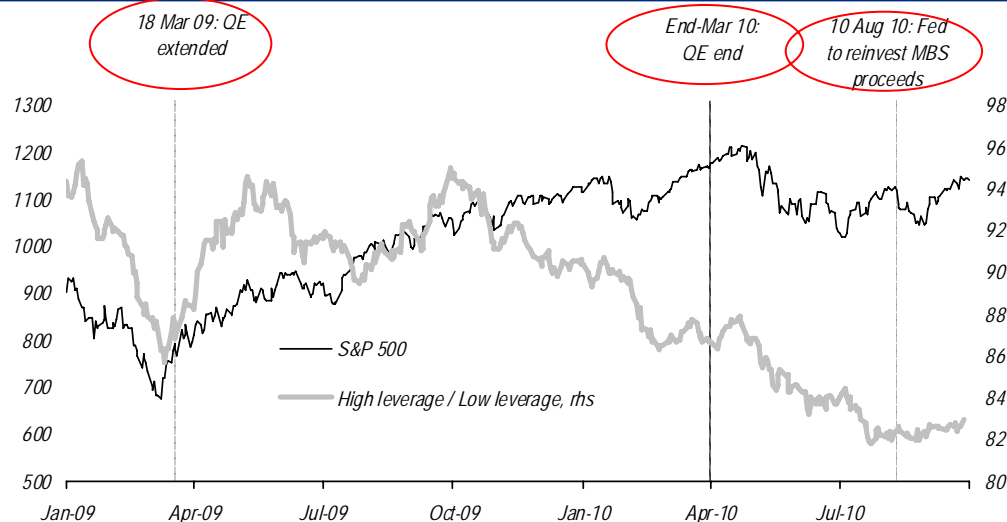
## Quality growth screen - Outperform- or Neutral rated European and US stocks that have asset turns better than peers, consistent EPS growth over the past 3 years and next two years

Company	# yrs since 2000 that CFROI > discount rate	Asset turnover (2008)	EPS growth					CS Rating
Capita Group Plc (The)	11.0	3.0	17%	23%	16%	13%	11%	Outperform
Compass Group Plc	10.0	4.0	9%	39%	43%	18%	12%	Outperform
Imperial Tobacco Group Plc	10.0	2.5	12%	15%	18%	11%	6%	Outperform
Indra Sistemas	11.0	1.7	16%	21%	9%	2%	3%	Outperform
Novo Nordisk As	10.0	0.4	34%	16%	15%	26%	20%	Outperform
Petrofac Limited	8.0	3.1	49%	50%	32%	17%	13%	Outperform

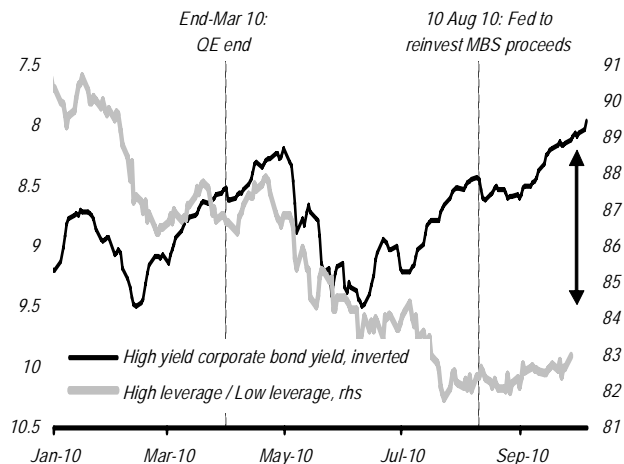
Company	# yrs since 2000 that CFROI > discount rate	Asset turnover (2008)	EPS growth					CS Rating
			2007	2008	2009	2010	2011	
Aflac Inc	11.0	2.0	15%	22%	22%	13%	10%	Outperform
Amerisourcebergen	11.0	28.3	20%	11%	17%	27%	9%	Outperform
Ball Corp	11.0	1.1	21%	3%	12%	13%	13%	Outperform
Crown Holdings	10.0	1.0	12%	31%	18%	7%	14%	Outperform
Ecolab	11.0	1.2	16%	12%	7%	13%	13%	Outperform
Express Scripts Inc	10.0	4.6	44%	31%	15%	40%	27%	Outperform
Medco Health Solutions Inc	8.0	2.6	31%	28%	21%	19%	17%	Outperform
Pepsico Inc	11.0	1.2	13%	9%	1%	12%	11%	Outperform
Schein (Henry)	11.0	3.0	26%	15%	8%	11%	12%	Outperform

# The leverage style outperformed by 10% during QE1, but has recently lagged the fall in corporate bond yields and the rise in equity sector risk appetite as QE2 has become increasingly likely

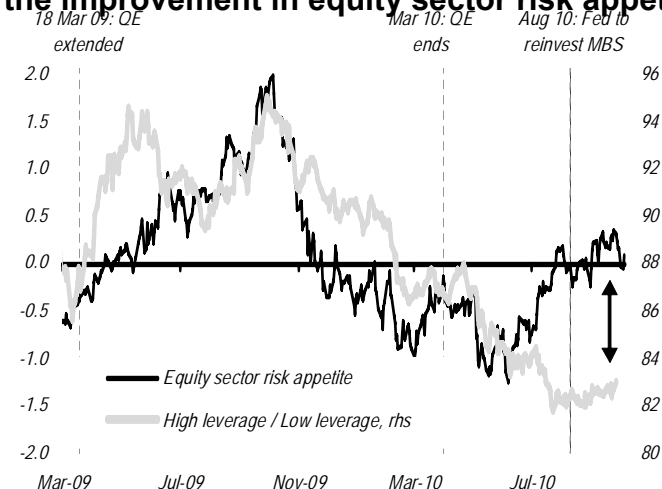
The leverage style underperformed after QE ended in the US – a return to QE could lead to high leverage outperforming



The performance of the leverage style has lagged the fall in the cost of corporate debt

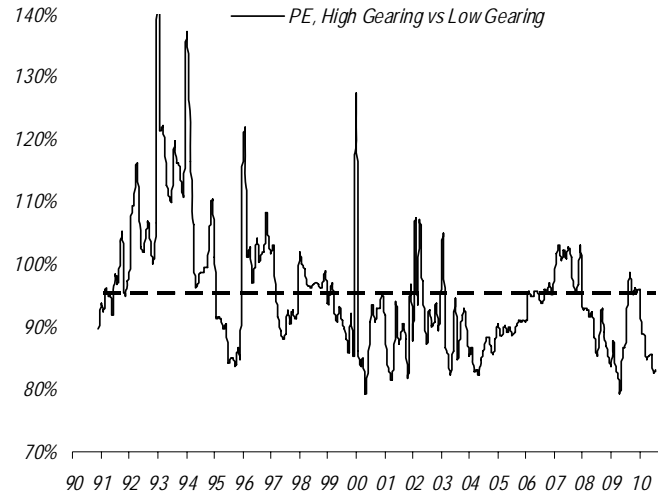


The performance of the leverage style has lagged the improvement in equity sector risk appetite

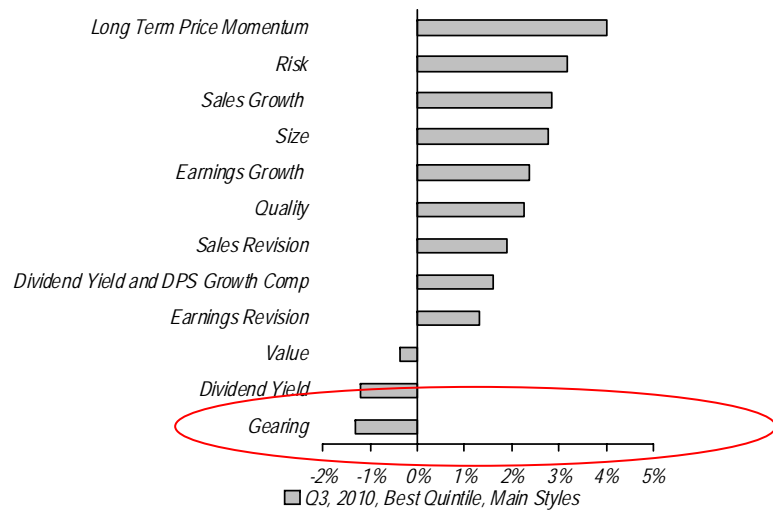


# High leverage is cheap relative to low leverage after being the worst performing style in Q3 and YTD

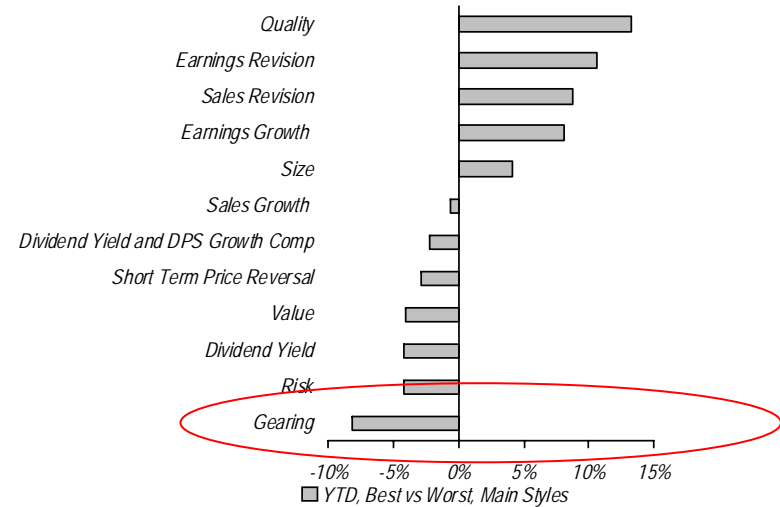
The P/E of the high gearing quintile is trading 13% below average relative to the low gearing quintile



## Q3 style performance – long top quintile / short bottom quintile



## YTD style performance



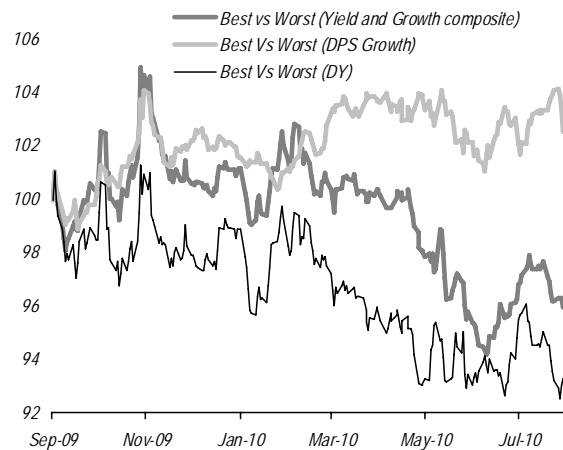
## Outperform- or Neutral-rated stocks with higher leverage and better sales growth expectations than their sector and the market

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Name	Leverage	Sales Growth		Earnings Revisions		Long Term Price Momentum		Credit Suisse rating
	Net debt to equity	FY 1 Growth	FY2 Growth	1 m Revisions	3 m Revisions	12 m Price Momentum	RSI	
Seadrill	1.28	16.9	15.1	3.3	-8.3	37.4	69.8	Neutral
Renewable Energy	0.60	35.4	22.8	33.3	366.7	-52.4	33.4	Outperform
Saras	0.64	36.2	10.3	-50.0	-62.5	-44.4	39.7	Outperform
Voestalpine	1.46	19.8	5.7	5.5	316.7	4.3	58.1	Outperform
Acciona	1.52	8.8	5.9	-7.5	-10.4	-31.1	32.6	Outperform
Heineken	1.45	12.9	8.8	1.2	1.6	20.0	72.0	Neutral
Terna	2.07	12.3	6.1	0.0	5.3	23.4	74.3	Neutral
Yara International	0.64	6.7	7.4	0.9	-5.1	55.3	63.8	Neutral
Fresenius Pref.	1.85	9.9	7.1	2.5	3.6	41.2	80.6	Outperform
Enagas	1.73	11.4	8.1	0.0	0.7	1.3	50.3	Neutral
Bureau Veritas	1.54	6.2	13.9	1.5	4.2	36.4	76.2	Neutral

The combination of high dividend yield and DPS growth tends to perform better than the simple dividend yield style. Moreover, DPS growth stocks are cheaper than high yielding stocks and DPS growth as a style has a beta close to 1.

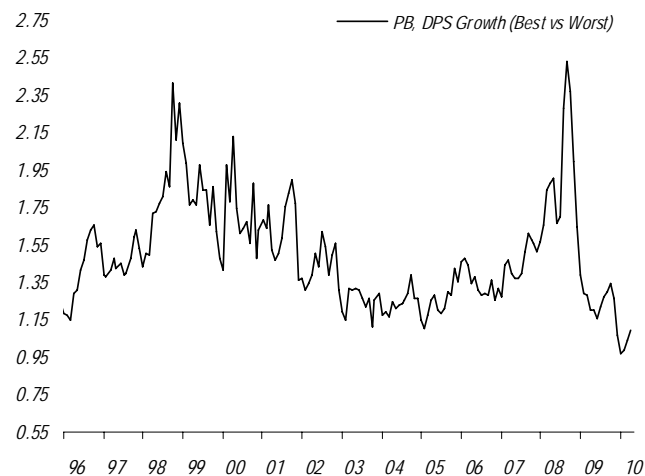
DPS growth has been the best performing dividend based style in the last 12 months



High yielding stocks look expensive relative to low yielding stocks...



... While high DPS growth is cheap



## Credit Suisse Outperform- or Neutral-rated European stocks with 12m fwd DY and DPS growth expectations above the market median

NAME	Dividend yield		----- DPS growth -----			Spread of analyst estimates around mean - DY1, %	Credit Suisse Rating
	Actual	FY1 DY	FY1	FY2	FY3		
ADMIRAL GROUP	3.3	3.9	16%	38%	38%	6.2	Neutral
BBV.ARGENTARIA	3.39	4.29	26%	59%	51%	22.1	Outperform
BNP PARIBAS	2.76	3.51	27%	61%	47%	20.9	Outperform
BRITVIC	3.19	3.72	17%	28%	29%	3.8	Neutral
HENNES & MAURITZ 'B'	3.09	3.66	18%	31%	25%	5.5	Outperform
IMPERIAL TOBACCO GP.	3.82	4.50	18%	29%	23%	5.1	Outperform
LADBROKES	2.50	5.00	100%	100%	25%	8.1	Neutral
RED ELECTRICA CORPN.	4.28	4.89	14%	30%	25%	6.0	Outperform
REXAM	2.49	3.87	56%	78%	29%	7.2	Neutral
SAINT GOBAIN	3.03	3.33	10%	27%	31%	9.8	Outperform
STORA ENSO 'R'	2.82	3.10	10%	25%	27%	15.0	Outperform
TELENOR	2.66	3.69	39%	71%	49%	14.3	Neutral
TNT	2.64	3.04	15%	36%	34%	8.4	Neutral

# Disclosures

## Disclosure Appendix

### Important Global Disclosures

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Neutral (N): The stock's total return is expected to be in line with the relevant benchmark\* (range of  $\pm$ 10-15%) over the next 12 months.

Underperform (U): The stock's total return is expected to underperform the relevant benchmark\* by 10-15% or more over the next 12 months.

\*Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe\*\*, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. Some U.S. and Canadian ratings may fall outside the absolute total return ranges defined above, depending on market conditions and industry factors. For Latin American, Japanese, and non-Japan Asia stocks, ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark; for European stocks, ratings are based on a stock's total return relative to the analyst's coverage universe\*\*. For Australian and New Zealand stocks a 22% and a 12% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively, subject to analysts' perceived risk. The 22% and 12% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively, subject to analysts' perceived risk.

\*\*An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.

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Overweight: Industry expected to outperform the relevant broad market benchmark over the next 12 months.

Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.

Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.

\*An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.

\*\*The broad market benchmark is based on the expected return of the local market index (e.g., the S&P 500 in the U.S.) over the next 12 months.

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Neutral/Hold*	42%	(59% banking clients)
Underperform/Sell*	14%	(52% banking clients)
Restricted	2%	

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