

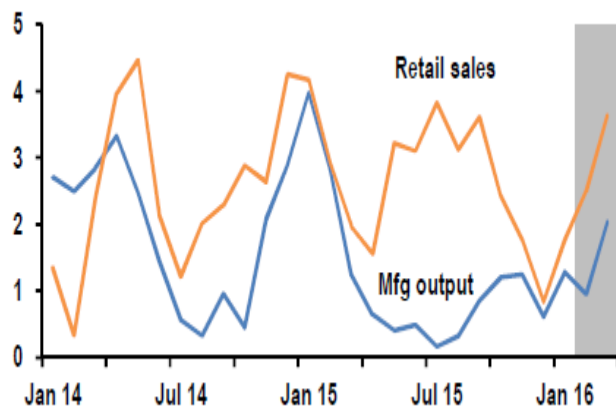
## The Month Ahead Apr 2016:

### The sign says valetudinarian people need not apply.

What a quarter it has been for 2016, investors vacillated from fear to feh but throughout we have advocated faith. Central to our sophrosyne and sanguine views has been resilient end sales especially in DM underpinned by healthy gains in re-employment and incipient increase in wages. DM end sales for 1Q16 is tracking a 3.6% ar growth rate reversing less than 1% growth in 4Q15. Moreover, real wage growth in DM is tracking close to 4% increase qoq in 1Q of the year; higher than the average of past 3 quarters. Oil collapse is but a transfer of wealth from oil producers to oil consumers and given that 60% of global economy depends on consumption, the precipitous drop in oil is net beneficial to global growth.

**DM 1Q16 end retail sales is strong**

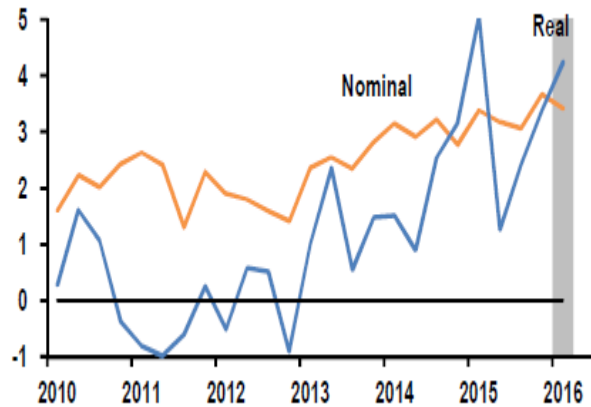
%3m/3m, saar. Feb 16 and Mar 16 est



Source: J.P. Morgan

**Wages are improving in DM too**

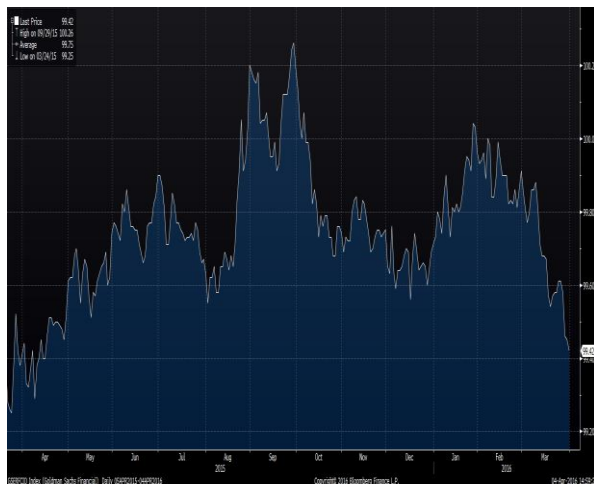
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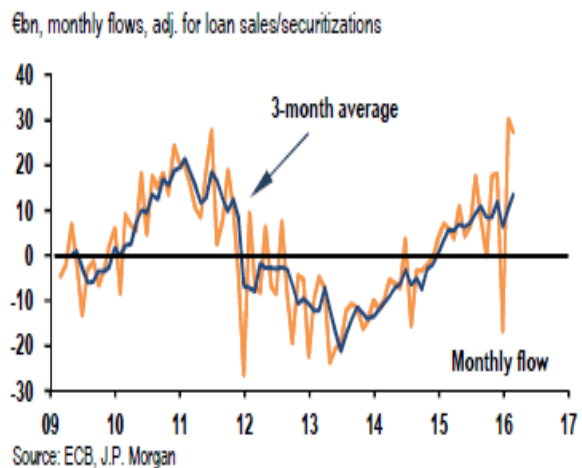
Source: J.P. Morgan

We have dismissed naysayers that central bankers' QE programs have been futile and policy tool kits are now hamstrung. The results of unconventional monetary tools deployed in the aftermath to 2008 GFC has been an equivocal success for the US and UK with significant restoration of employment for both countries and improvement in individual and corporate balance sheet. We judge Europe still a work-in-progress but Japan has been an abject failure with the possibility of Japan entering another technical recession in less than 3 years since Abenomics was undertaken. Central bankers have shown creativity with the recent times deploying Negative Interest Rate Policy (NIRP). NIRP is meant to lower the cost of borrowings but more potently meant to instigate lending by banks and to promote borrowing by consumers/corporates. We can judge conclusively that NIRP has achieved the former with financial conditions index, which encapsulates series of real rates, spreads and movements in risk assets, improving dramatically post NIRP. As for the latter, the jury is still out whether NIRP can alter behaviour modals towards credit and we caution any haphazard proclamations it wouldn't work. Preliminary loans data out of Europe have shown an improvement in loans disbursement as well as increase appetite to take on credit since ECB deployed NIRP back in Jun 2014. Europe is particularly important in assessing the efficacy of NIRP as it was the first economic bloc to adopt NIRP.

**Financial conditions improved post 1Q16 BOJ/ECB NIRP**

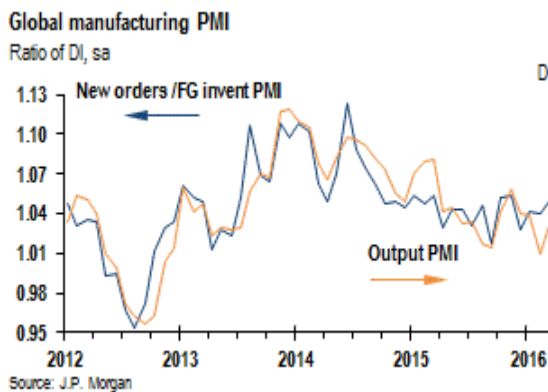


**EA loans improved since 1<sup>st</sup> NIRP in Jun 2014**

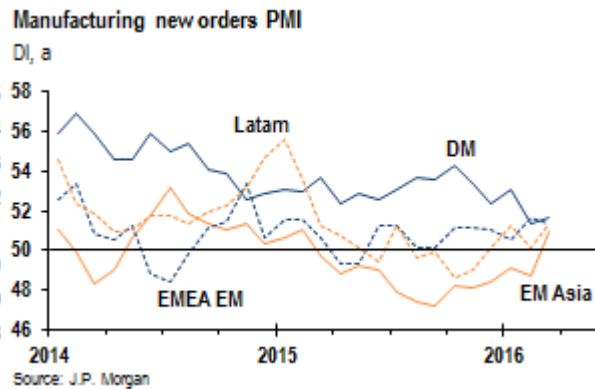


Finally, aiding to our constructive view of risk assets is our assertion the global manufacturing economy is at the cusp of a substantial rebound re-connecting with healthy end sales. March global PMI surveys are positive with the output index rising more that we had expected. The surveys level reversed much of the last two months' decline. The details of the report were also encouraging—notably the rise in the orders/inventory ratio and the large improvement in China's and other EM Asian countries' PMIs. This positive message was reinforced by March national surveys moving higher in in Japan, Germany and the US as well. Furthermore, we believe the cyclical uplift in manufacturing will last at least 2 quarters long.

**Higher Global PMI Output and New Order/Inventory**

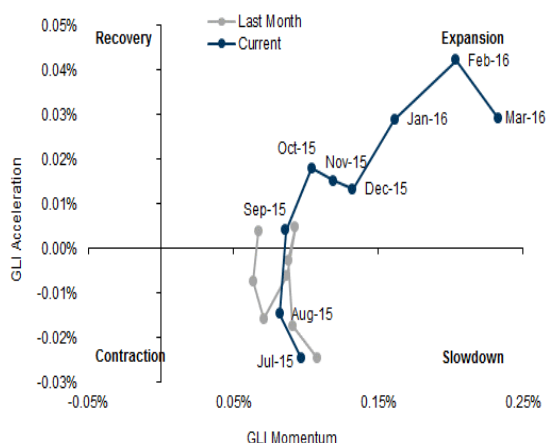


**EM seeing pronounced improvements**



According to GS. Risk of recession in the next four quarters has since abated from a high of 25% back in February to less than 20%. GS leading indicator is also firmly in the expansionary zone while the sub-indices of PMI categorized by type of goods are profiling an encouraging trend in which end sales index is stronger from previous months while intermediate goods, which can be construed as leading indicator of future demand, has also improved since its bottom in Dec/Jan. As we have consistently communicated since Feb, the market is pricing too much fear into an imminent recession, any valetudinarian thoughts must now be banished; well diminished would be the better choice of word.

**GS Leading Indicator back into expansion**



**Pick in PMI consumer and intermediate goods**

**J.P. Morgan global manufacturing sector PMI summary**

		Nov	Dec	Jan	Feb	Mar
<b>Consumer goods</b>	Output	53.1	52.8	53.7	50.7	51.7
	New orders	53.0	54.3	54.1	51.9	52.6
	Fin goods inv	49.6	50.4	49.5	49.2	50.4
<b>Investment goods</b>	Output	53.3	51.6	51.4	50.7	50.7
	New orders	52.6	50.8	50.9	49.0	50.5
	Fin goods inv	49.0	47.5	49.8	48.4	47.0
<b>Intermediate goods</b>	Output	51.0	50.5	49.9	49.8	51.0
	New orders	49.2	48.3	49.7	50.1	50.7
	Fin goods inv	47.6	49.7	49.0	48.0	48.6

Source: J.P. Morgan, Markit

But as a veteran in this business, this writer is always on the lookout for risks and knows that complacency is a death knell when it comes to managing money. So what are the key risks?

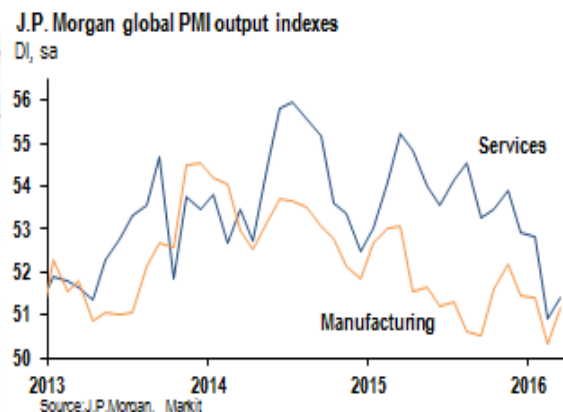
First risk is that manufacturing could splutter again either due to inventory build-up or more insidiously a slowdown in end demand. While we cannot rule out the former and would like to see another month of data to re-affirm our bullish view, we believe the latter happening is quite remote as we do not see any risks of employment gains reversing. Latest US Services PMI showed an improvement in employment, business activity and new orders. The improvement in March survey is quite remarkable given that risk markets have been extremely volatile in months of Feb and Mar underscoring the strength of the US economy.

**US Non-manufacturing remains strong**

**Nonmanufacturing ISM survey**

Sa	Sep 15	Oct 15	Nov 15	Dec 15	Jan 16	Feb 16	Mar 16
Nonmanufacturing index (NMI)	56.7	58.3	56.6	55.8	53.5	53.4	54.5
Business activity (25%)	60.1	61.8	59.4	59.5	53.9	57.8	59.8
New orders (25%)	56.4	60.8	57.9	58.9	56.5	55.5	56.7
Employment (25%)	57.9	58.4	56.0	56.3	52.1	49.7	50.3
Prices	49.1	49.4	50.0	51.0	46.4	45.5	49.1

**Global Services and manufacturing in tandem recovery**

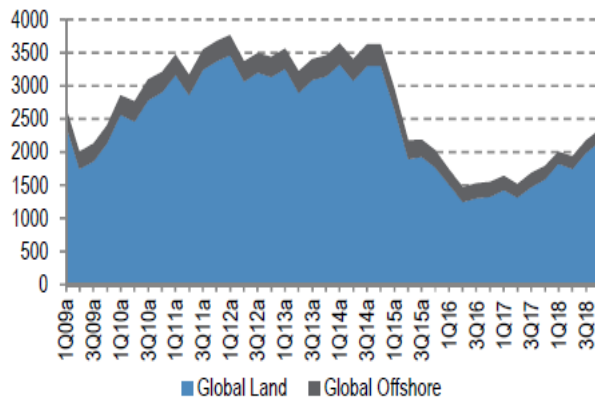


The second risk is that of disorderly policy responses with regards to China's monetary and currency policies. We believe monetary policy will remain accommodative but future rate cuts in 2Q16 are quite unlikely as they have already reached their threshold of further cuts given real rates are close to zero now. Inflation is forecast to rise in the coming month as food inflation comes to fore preventing PBOC from cutting rates. The unintended consequence of PBOC staying pat on the monetary front is that it will alleviate pressure of capital flows. But it is China, anything can happen.

Lastly, the risk of galloping inflation must be carefully monitored. Our advice to buy oil when it dips below \$30 back in January doesn't seem quite quixotic now. The main reason for our contrarian call is that we believe there that a severe capex and rig count reductions could lead to an undersupply of oil from 3Q16 to 1Q17. We believe regardless of any deal in April 2016 on OPEC suspending production, crude oil will still be undersupplied by 3Q16 and head towards \$50 in 2H16.

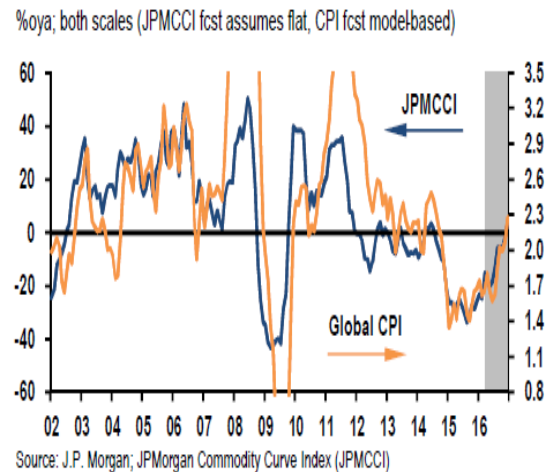
The implication for a rising crude oil will be felt through the channels of higher inflation. Compounding this risk of rising inflation is the perplexing quagmire of decline productivity globally, which we have written in past editions. If wages continue to increase and without a commensurate or more improvement in productivity, other inputs costs will also increase, accelerating a rise in inflation and impinging on profit margin. For now, we see inflation ending the year around 2.6% to 2.8%, within the tolerable range for central bankers who have been fighting deflation for the past 5 years.

**Precipitous decline in oil rigs from 2Q15 till 2Q17**



Source: Baker Hughes and J.P. Morgan estimates.

**Watch the rise of galloping inflation.**



Source: J.P. Morgan; JPMorgan Commodity Curve Index (JPMCCI)

**Asset Allocation Strategy:**

We are overweight equities given our views above and taking down our bond portfolio while maintain our idiosyncratic exposures in alternatives such as trend-followers and global macro managers.

**Equities: Overweight (Europe – Maintain Overweight, EM - Overweight from Neutral, US - Neutral but downgrade Japan – Overweight to Underweight)**

At the country level, we gravitate towards economies and stock markets that will benefit from an accelerating manufacturing impulse against an easing monetary policy backdrop. Hence, our preference is to overweight manufacturing heavy Europe and commodities heavy EM. In US, we have neutralize our underweight as we believe Fed has effectively delayed further rate hike till Jun and further hikes will be fewer and moderate. The prospect of earnings upgrade is probable given our bullish view on oil. If oil hits our \$50 view, there’s an uplift of 5 percentage points increase from current EPS estimate putting EPS growth of 14% for the year reversing last year -1% decline in EPS. However, we as well as consensus have been absolutely wrong on overweighting Japan as it was the worst performing DM markets in 1Q16. Weak economic outcome including an imminent second technical recessions in three years for Japan, rising currency, weakening corporate and consumer sentiments and risk of earnings downgrade are reasons why we have altered our views to underweight Japan from overweight. Our contrarian views of an appreciating Yen espoused during our Jan outlook has proved to be prescient and we believe the risk of 90-100 YEN/USD is probable by year end which could result in a 10 percentage points downgrade in EPS for Topix from 11% to 0% in FY17 putting TOPIX as the only index with no growth among the DM markets.

### Upside EPS upgrade risk for US

**Sensitivity of 2016E EPS to Brent Crude Oil**

\$10 change ≈ 4% change to S&P 500 EPS

Brent Crude Oil		Change in 2016E EPS							
2016E		Revenue		Write-downs		S&P 500		S&P 500 EPS	
Avg	Yr/Yr	\$	%	\$	%	\$	%	Level	Growth
\$57	9 %	\$2.11	1.9 %	\$3.44	3.1 %	\$5.54	5.0 %	\$115	15.0 %
52	(0)	1.58	1.4	3.44	3.1	5.02	4.6	115	14.5
47	(10)	1.05	1.0	3.44	3.1	4.49	4.1	114	14.0
42	(19)	0.53	0.5	1.72	1.6	2.24	2.0	112	11.8
<b>37</b>	<b>(29)</b>	<b>110</b>	<b>-</b>	<b>110</b>	<b>-</b>	<b>110</b>	<b>-</b>	<b>110</b>	<b>9.5</b>
32	(38)	(0.53)	(0.5)	(1.72)	(1.6)	(2.24)	(2.0)	108	7.3
27	(48)	(1.05)	(1.0)	(3.44)	(3.1)	(4.49)	(4.1)	105	5.0

Source: Goldman Sachs Global Investment Research.

### Downside EPS risk for Japan

FX Level (¥/US\$)	100	110	120 (GS Assum.)	
			130	140
RP growth %	-0.6	3.0	6.6	10.2
NP growth %	-1.0	5.8	10.9	15.8
EPS (¥)	¥91.5	¥97.8	¥102.6	¥107.1

Source: Company data, Goldman Sachs Global Investment Research

### Bonds : Downgrading to Underweight from Neutral

We made slight changes to our bond portfolio reducing its weight for larger equity exposures. In line with our views of a benign path of Fed's rate hike in the coming months, we have added duration in UST 20 years as well as increase our exposure to EM credit for yield pickup. After its run-up, we have taken profit our capital securities (CoCo bonds) exposures which are heavy in European financials. Our bond portfolio retains in a bar-bell strategy in which 40% of the bond portfolio is invested in DM government securities where we will benefit from further QE and NIRP policies. The remaining is towards yield plays in EM credit, CoCos and unconstrained bond funds.

### Commodities: Upgrade to Neutral

We will be looking for opportunity to re-enter our oil trade in the coming weeks as we draw close to 17<sup>th</sup> April OPEC meeting. Any weakness from an impasse meeting is viewed as a buying opportunity. Though our preferred expression on commodities would be the second derivative via the equity markets, emerging markets ETF or oil majors like Shell because the latter are higher octane in price actions.

### FX: Long YEN and EUR against the USD and maintain short RMB/USD

While both the Yen and Euro have performed well up 6.4% and 4.5% respectively in last quarter, we believe there is still risk of further appreciation especially for Yen. Reinstating our view to stay long YEN and EUR to the USD. A gradual depreciation of the RMB is expected over the next 2 years and we are forecasting RMB to depreciate to 7.00 by year end. But a return of Jan-Feb 2016 capricious dislocation is unlikely to be repeated.

### Alternatives Investments: Increasing for non-correlated to market returns

We have added a quantitative trend follower manager that has very low correlation to both stocks and bonds in addition to our allocation to US and Asia L/S equity managers.

We have also been very bullish about real estate particularly in Europe and Japan. Even in US, its favourable demographics will underpin demand over the next 5 years where the home buying

population will rise to 1.3-1.5mn pa over the next five years higher than last five years demand of under 1mn.

**Cash: Reducing cash.**

**Featured Picture/Quote:**



“An individual with no covenant can operate in an anointing, but will have no authority.”

– Thea Harris