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Global Markets Research

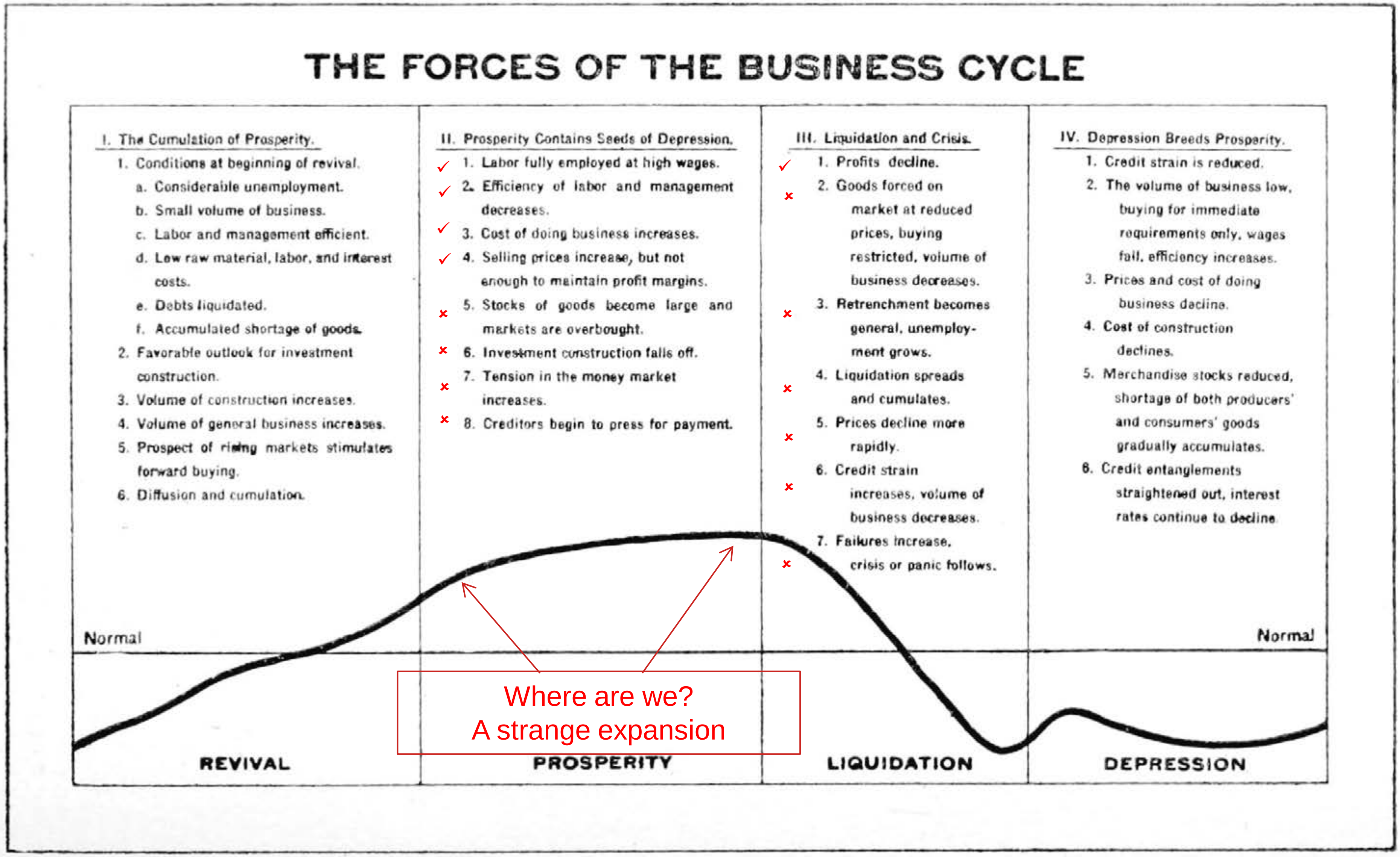
Macro & Market Scenarios

Kevin Gaynor
Head of International Research
+44 207 102 7800
kevin.gaynor@nomura.com
NomuraNow.com

January 2017

The view from 1922!

NOMURA

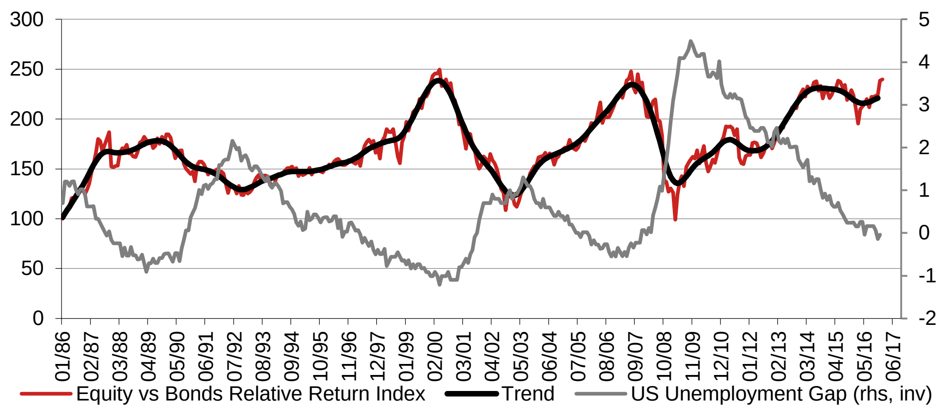


Source: Malcolm Churchill Rorty, "Some problems in current economics". AW Shaw Company, 1922

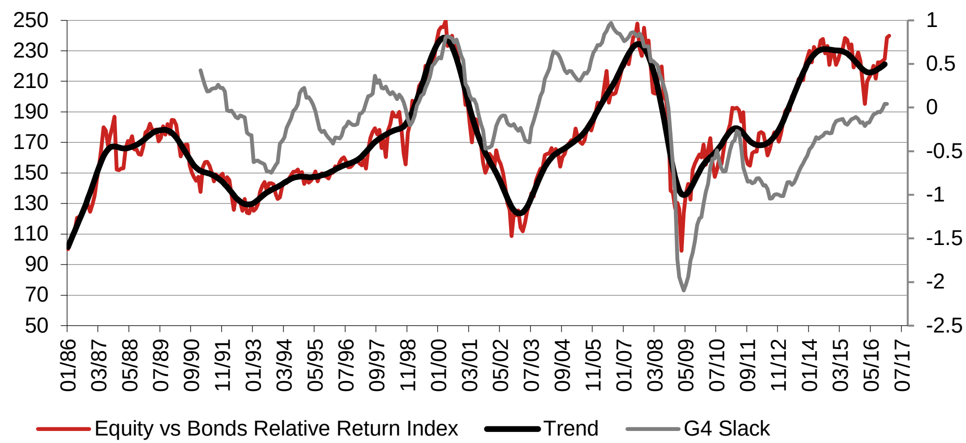
Measures of business cycle vs top-down returns

- After two years of underperformance global equities have been outperforming global government bonds. Performance in 14/15/16 was undermined by margin compression.
- This is typical for this point in the business cycle and reflected slow nominal GDP growth owing to slower real growth and a substantial downside surprise for inflation last year.
- The recent pick-up in observed and expected growth, combined with higher inflation points toward tighter output gaps through 2017 regardless of Mr Trump's policy agenda.

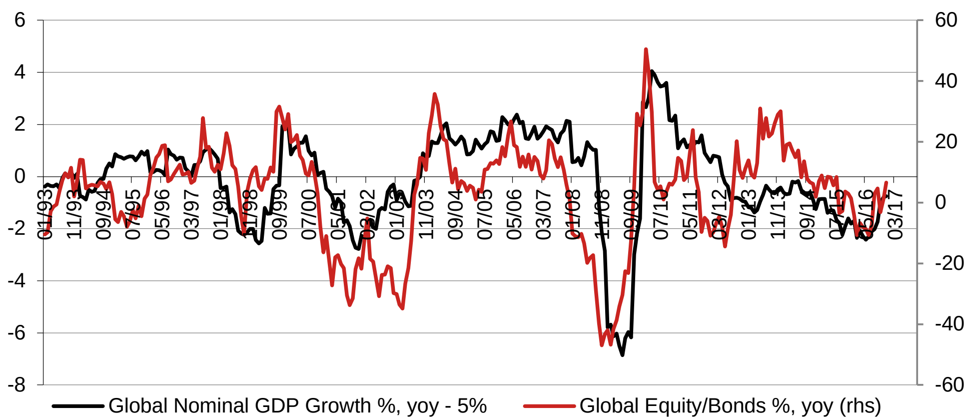
Global equity vs bond returns and US labour market slack



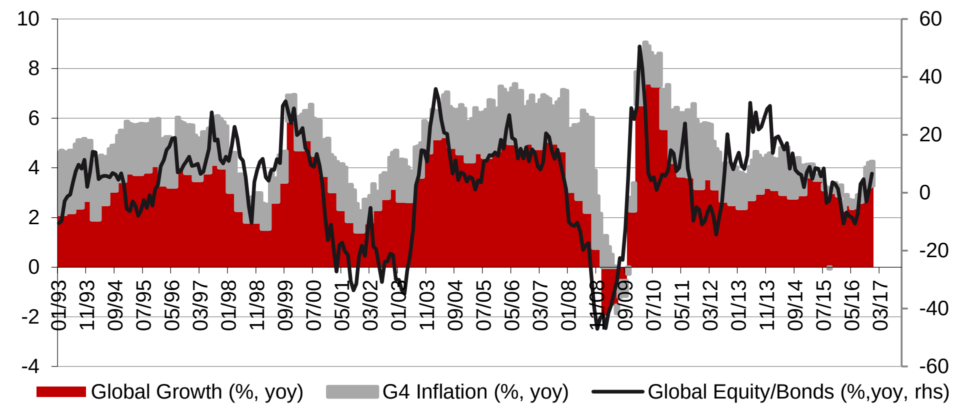
Global equity vs bond returns and G4 slack measure



Global equity vs bond returns nominal GDP growth



Global equity vs bond returns nominal GDP growth

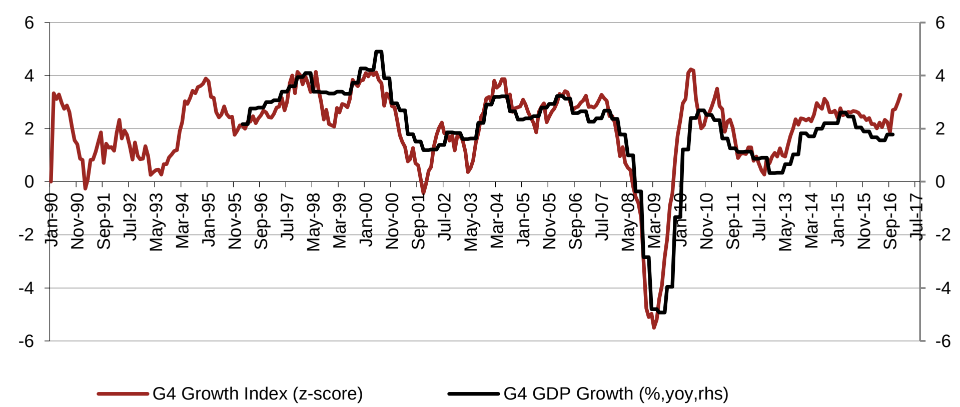


Source: Nomura, Datastream

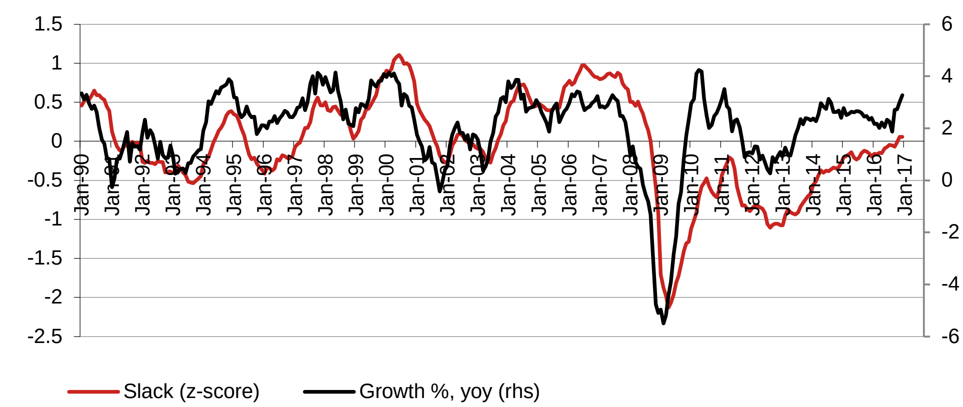
Macro context

- As we start 2017 measures of economic slack are moving toward balance for the developed economies.
- Actual growth measures have increased to an above trend rate recently.
- The implication is higher domestic core inflation pressures over the next 12 months.
- Given commodity price increases headline should move above core pointing to > 2.5% CPI.

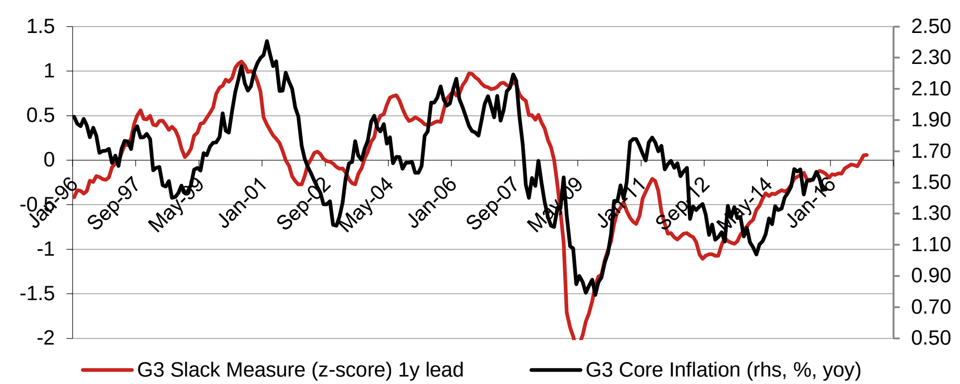
G4 growth measure vs actual



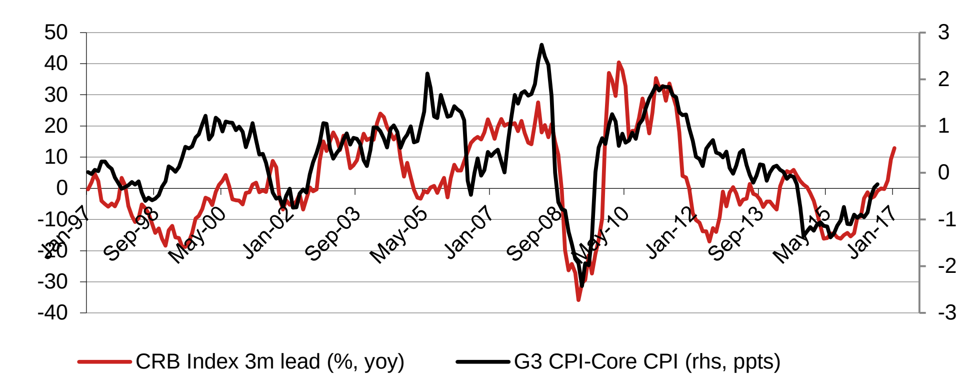
G4 growth and slack measure



Market returns based growth measure



CRB Index vs headline/core CPI gap

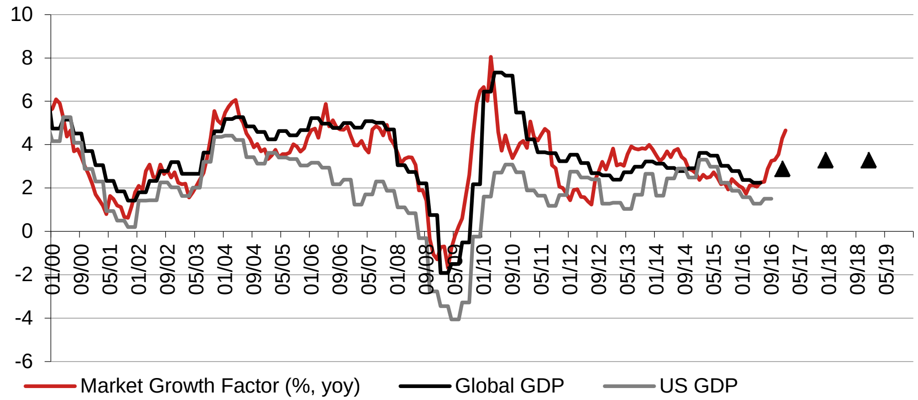


Source: Nomura, Datastream

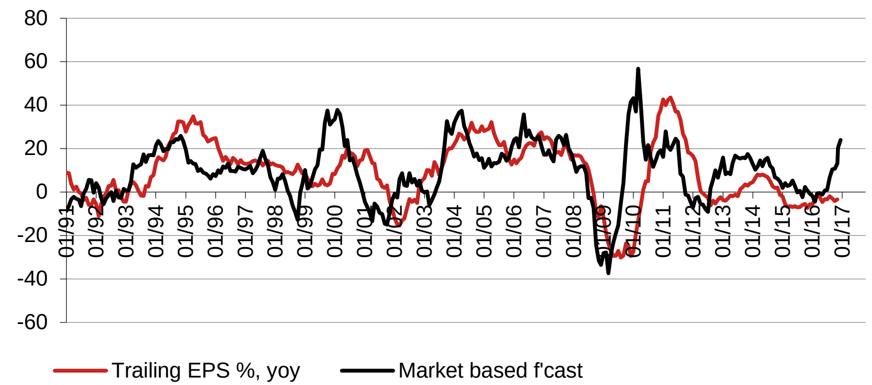
What is the market pricing?

- Our market returns based indicator shows a substantial pick-up in implied growth and EPS growth expectations.
- Higher breakeven inflation but a smaller increase in real yields.
- Risk asset discount rate hasn't increased despite higher nominal yields showing falling risk aversion as growth expectations increase.

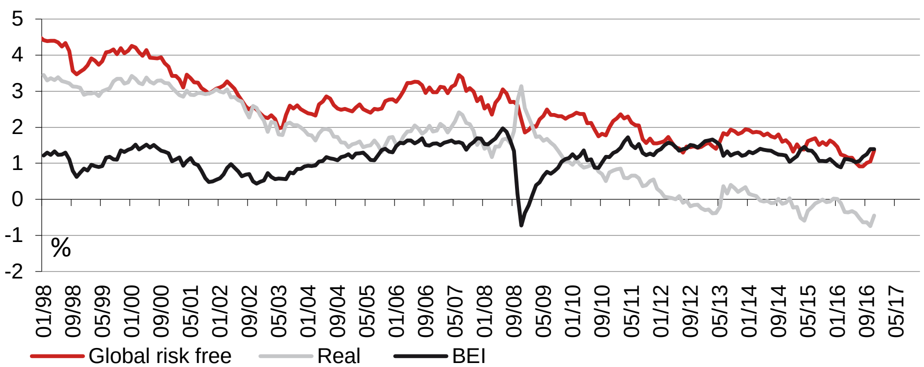
Market based forecast for real global GDP growth



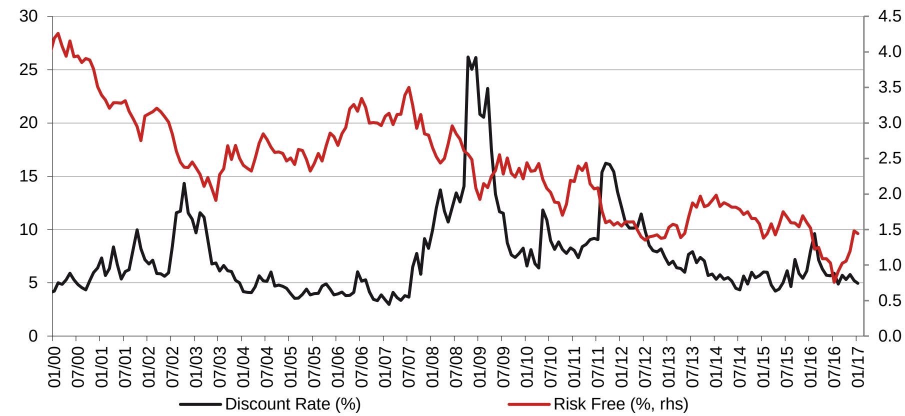
Market based forecast for global EPS growth



Global risk free and components



Discount rate stable despite sell-off in risk free rate

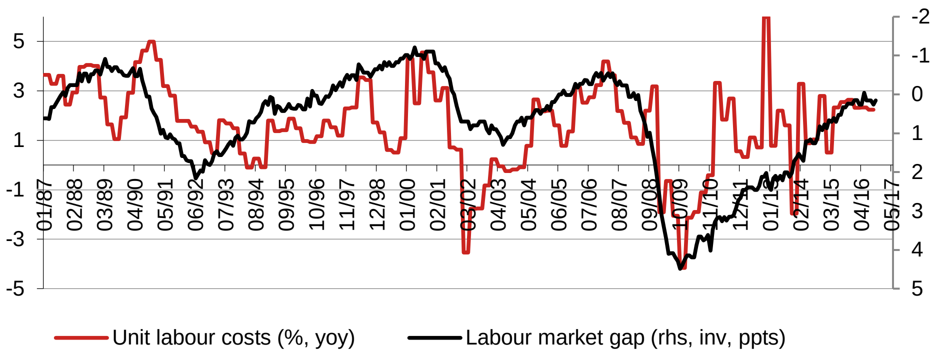


Source: Nomura, Datastream

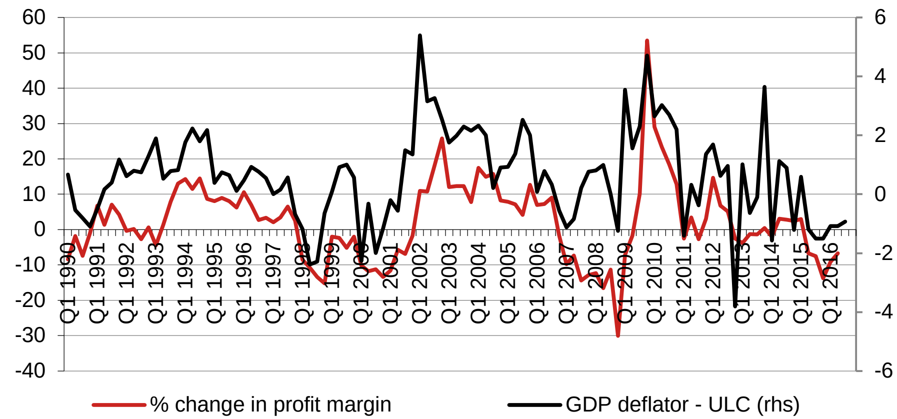
Is the market view warranted?

Tighter margins and higher cost of capital vs CEOs' growth expectations
RoE = margins x asset turn x leverage

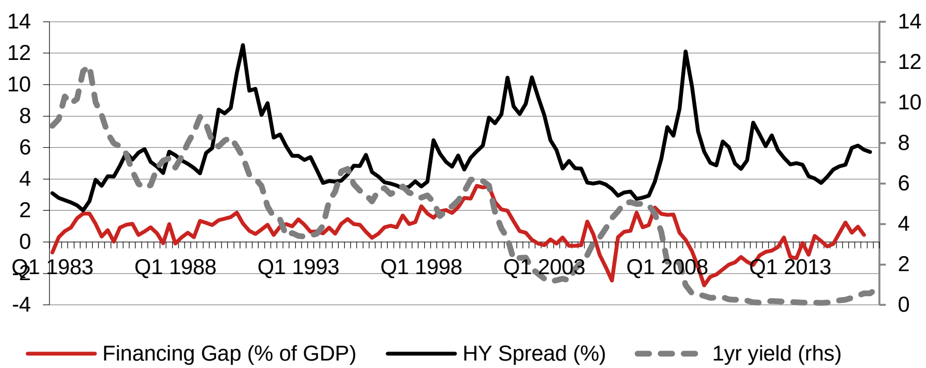
US labour market and unit labour costs



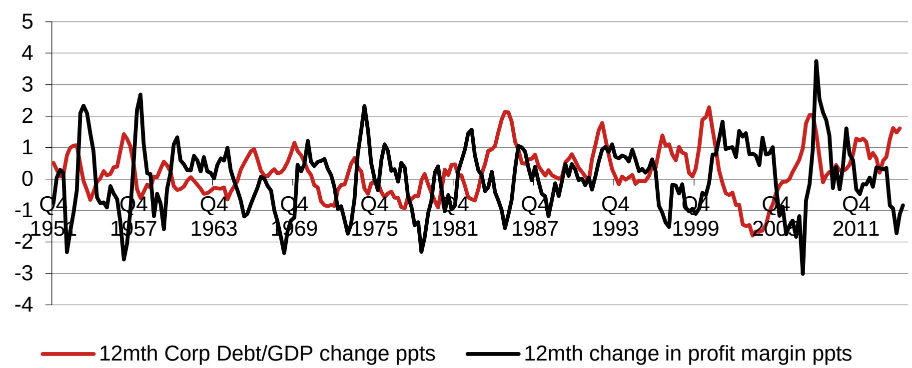
US profit margin and macro proxy



US financing gap and HY spreads



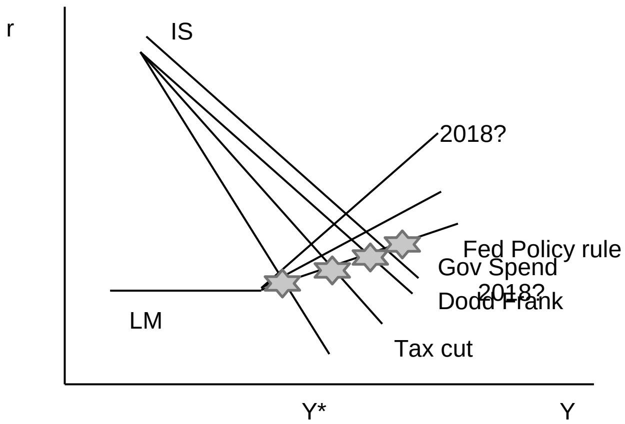
US profit margin and leverage change

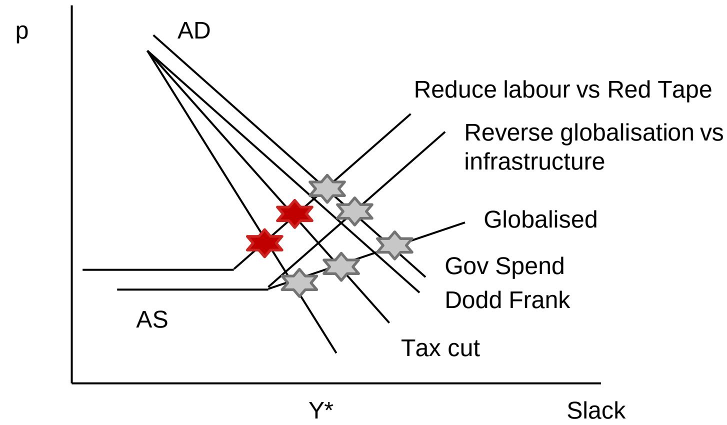


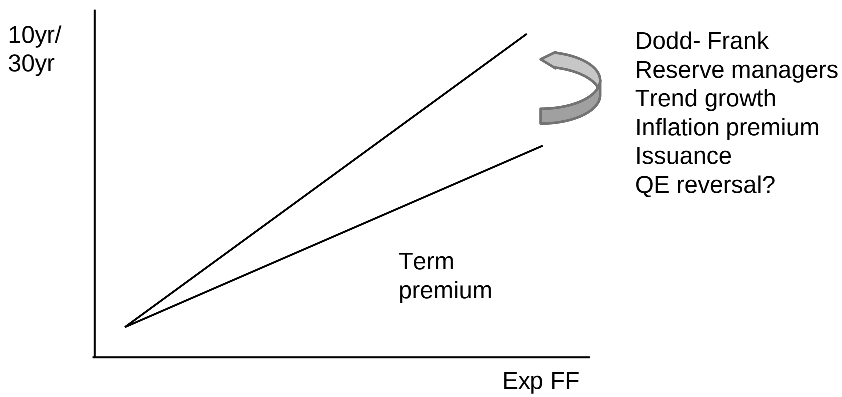
Source: Nomura, Datastream

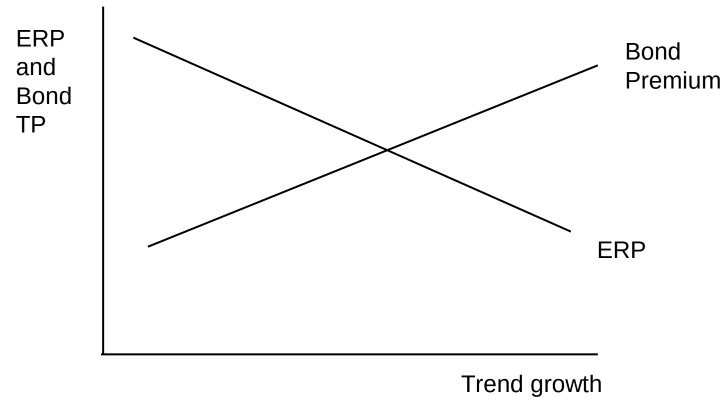
Trump-o-nomics

We understand the theory – question is what can be done and what gets done first.
Demand side first – and it's tax that matters – supply side later. Some inflation now – higher later?





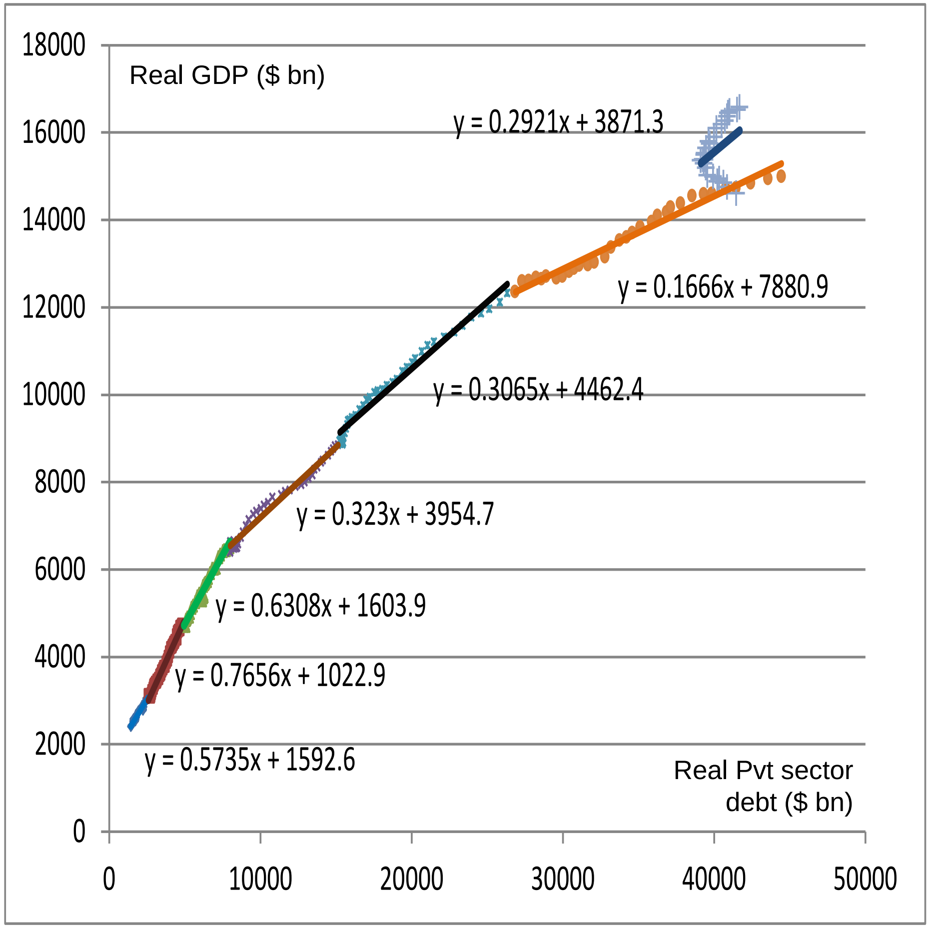




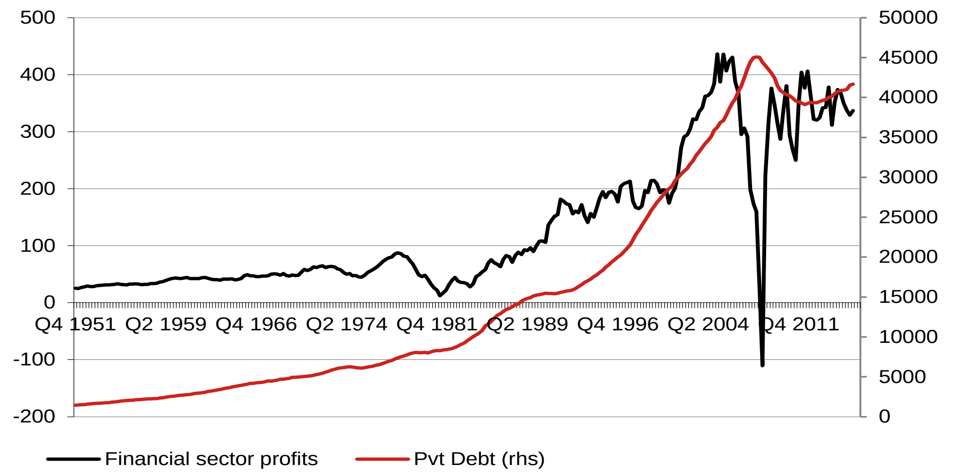
Source: Nomura

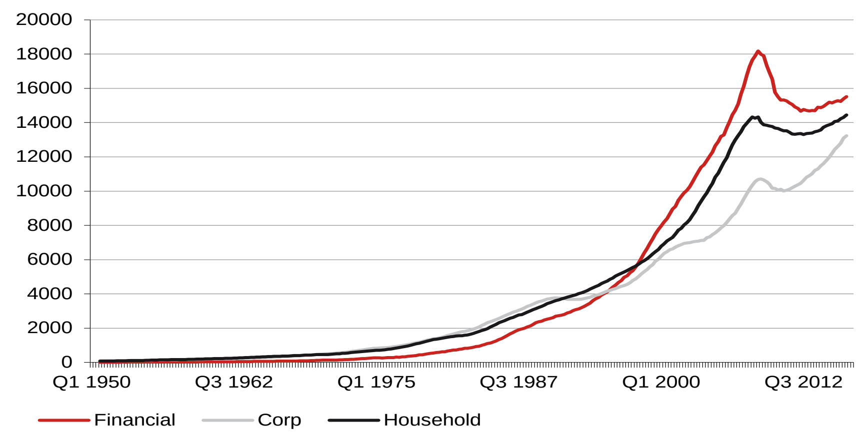
Inside/Outside money
Credit growth, GDP growth and financials profits

US private sector credit intensity of growth



Real Fin Profits, real debt stock and sectoral debt



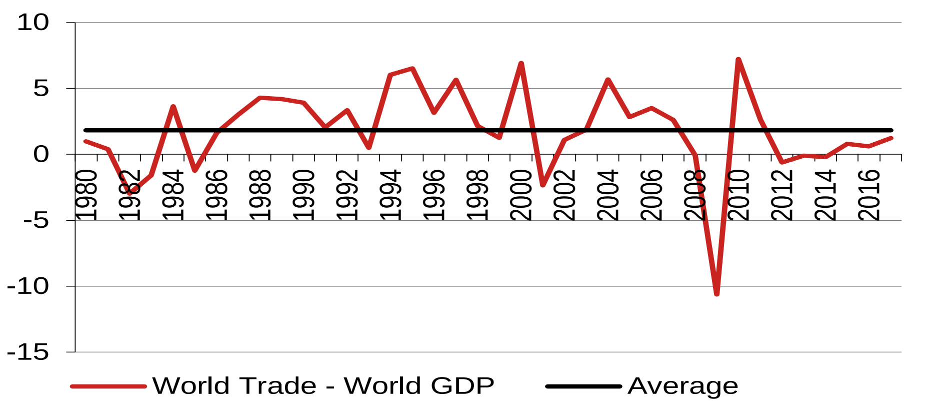


Source: Nomura, Macrobond, Datastream

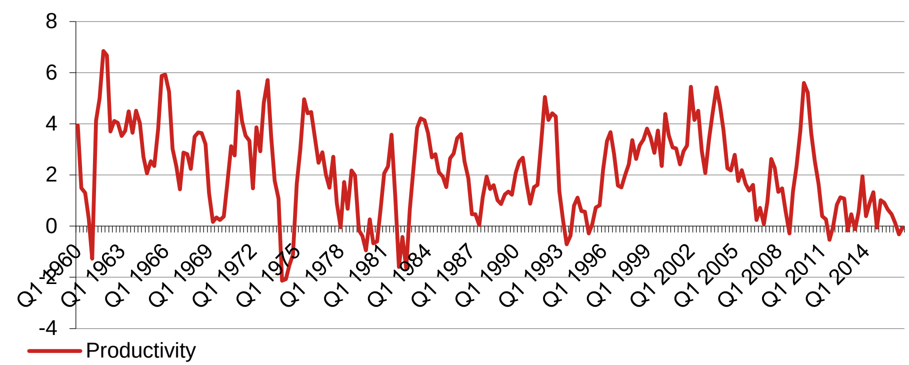
Macro context

- Globalisation has been conspicuously absent post 2008.
- Labour productivity in major economies has slowed.
- Capital stock is high in many economies – in the wrong sectors.
- EM is running an aggregate deficit on trade and DM has gone into surplus.

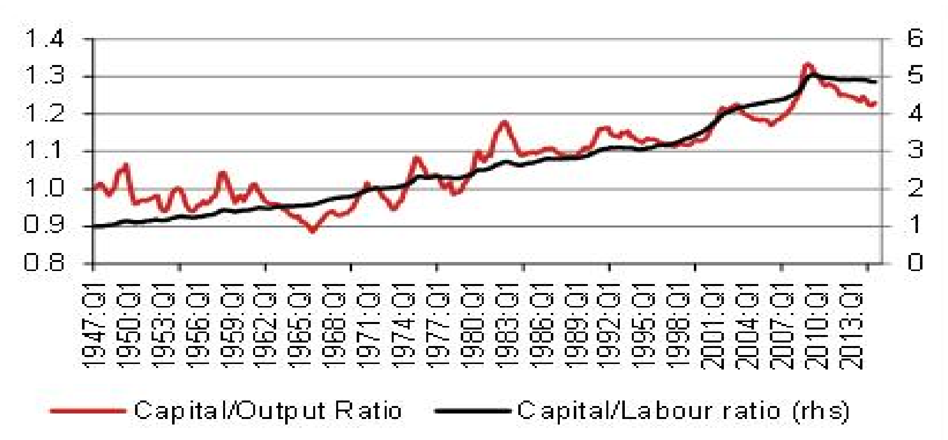
Global trade vs GDP



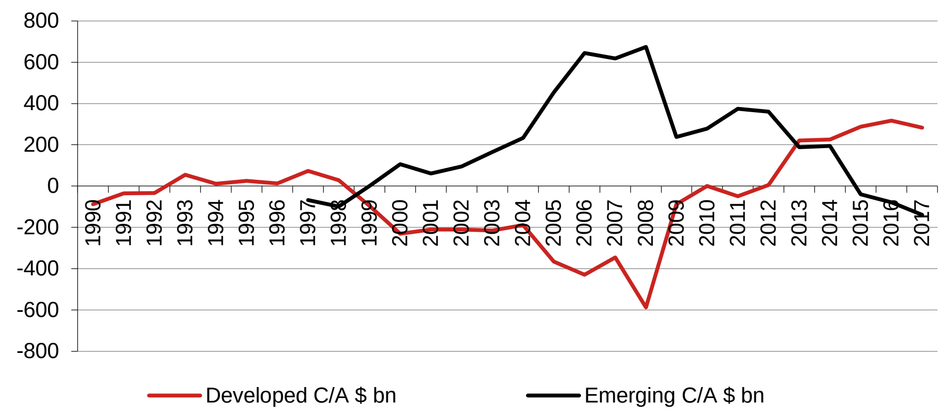
US Labour productivity growth



US Capital/labour ratio – still high vs trend



Flip in EM/DM current accounts – mostly EU related

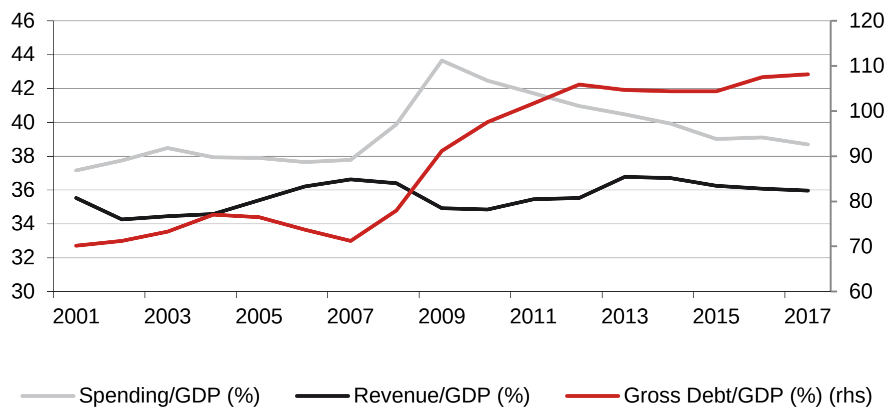


Source: Nomura, Datastream

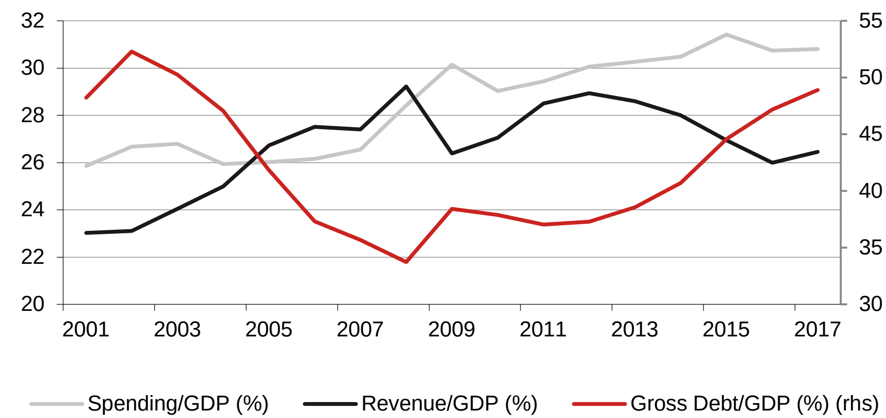
Macro context

- DM fiscal situation has improved on a flow basis but debt stock remains stubbornly high
- EM fiscal situation is deteriorating as spending is up and revenues down. 10ppt debt increase in three years.
- Credit growth slowing in EM, steady improvement in DM.
- EM export prices rising finally.

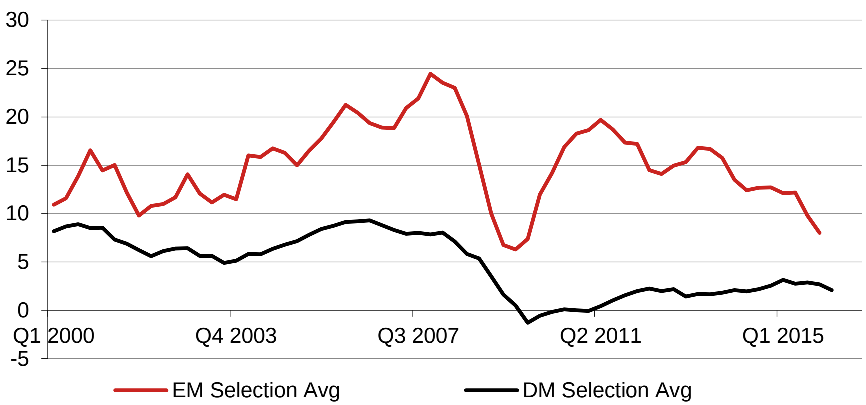
DM fiscal position has stabilised but is weak



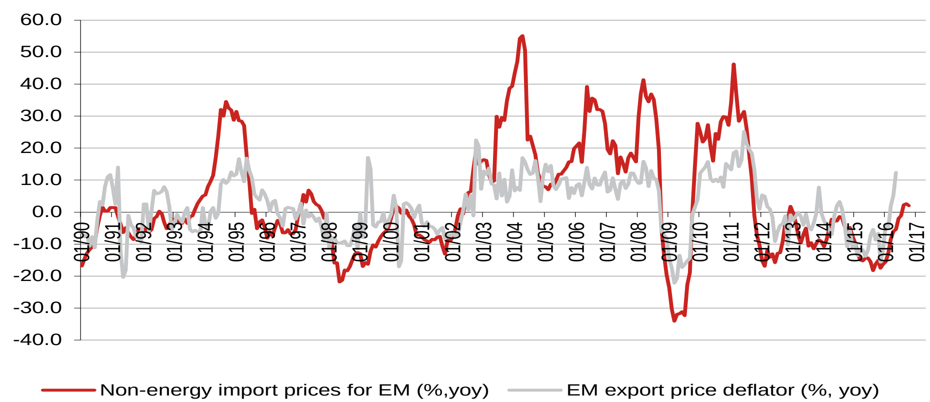
EM has worsened as revenues have slowed. Debt growing



Credit growth slowing across EM and modestly higher in DM



After four years of deflation EM export prices recovering

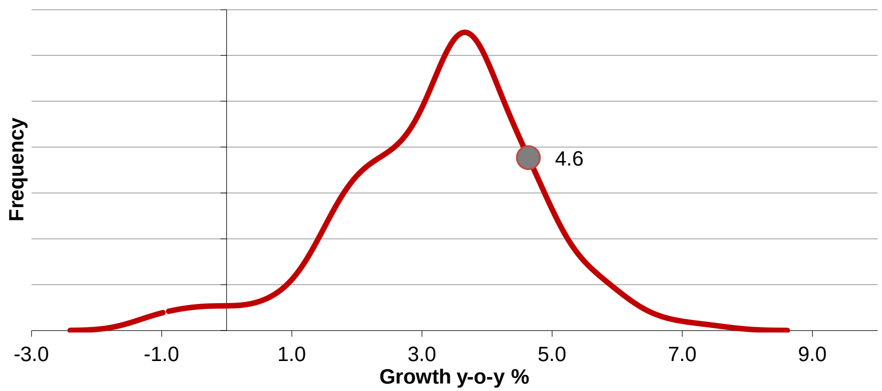


Source: Nomura, Datastream

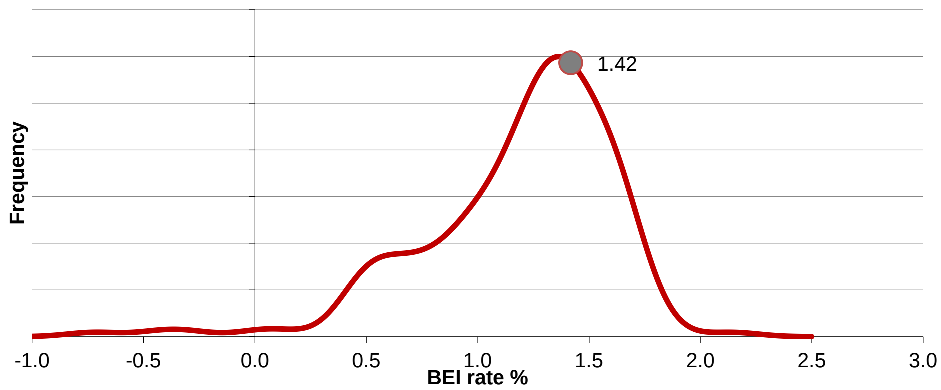
Current market settings vs history

- The market has dramatically increased its implied growth rate – only 20% of observations since 1990 have been higher.
- Global Index BEI inflation is now at the long-run median – only 30% of observations since 1990 are higher.
- Risk premium has fallen toward its long-run median – 40% of observations are lower -> i.e. we define anything below 3% as entering bubble territory.
- Developed market bond index yield is below 94% of historical observations.

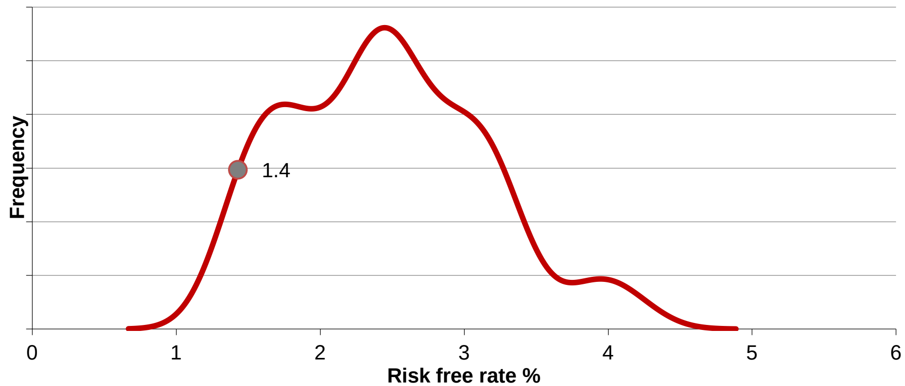
Market implied global real growth (%, y-o-y)



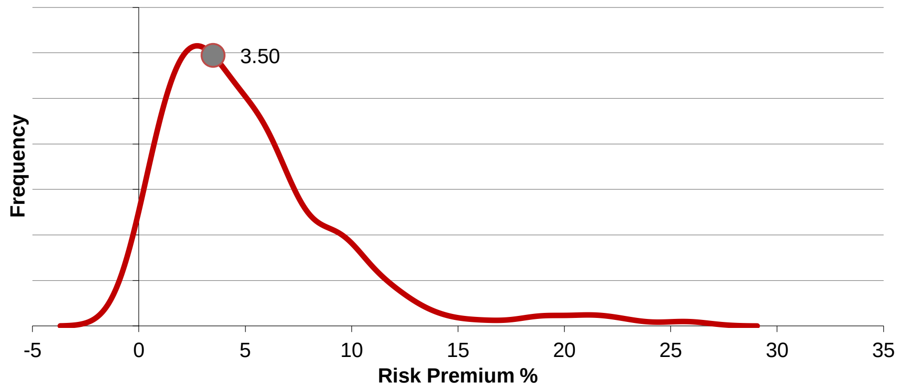
Global BEI index implied inflation (%)



Developed market bond index yield (%)



Market risk premium yield (%)

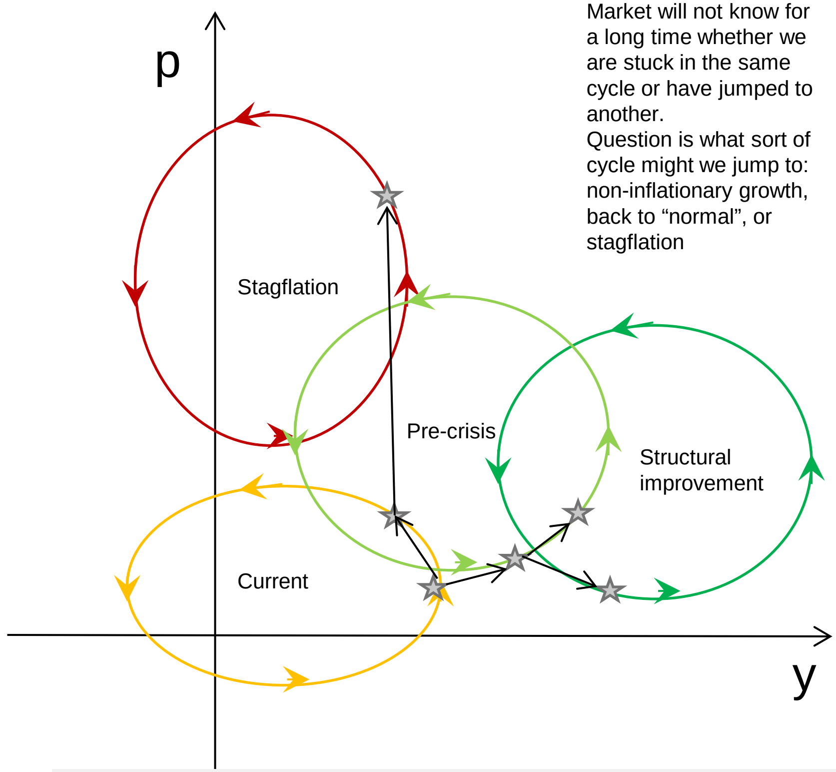


Source: Nomura, Datastream

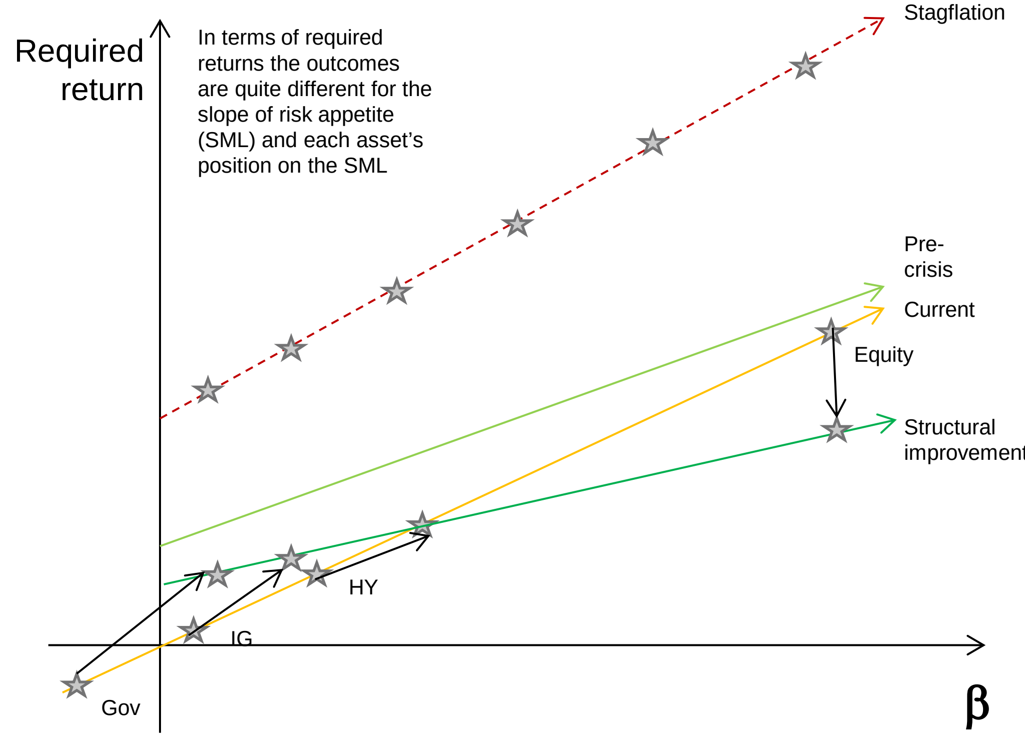
2017 – cyclically heating up, structurally unclear

- **We have a cyclical story that is clear (and fairly priced?).**
- **Structural impact will take time to become clear.**
- **What happens to the economy will decide the shape of the securities market line.**

What sort of economy? Structural & cyclical change?



What sort of market? Taking returns back to "normal"?



Scenarios

	Growth (%)	Risk Free (%)	Risk Premium (%)	Gov	IG	HY	MSCI	Commodities	EQ/Gov
				Annual Returns (%)					
Full Trump	4.0	3.0	2.0	-5.3	-8.9	-3.4	9.4	6.3	14.7
No Change	2.0	1.2	6.0	3.0	2.5	4.2	-0.8	-2.4	-3.8
Inflation	1.0	2.0	7.0	-0.7	-6.4	-11.6	-14.5	-11.7	-13.8

Source: Nomura

Appendix A-1

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• Fundamental analysis regarding whether a security’s price deviates from its underlying macro- or micro-economic fundamentals.
• Quantitative analysis of price variations.
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