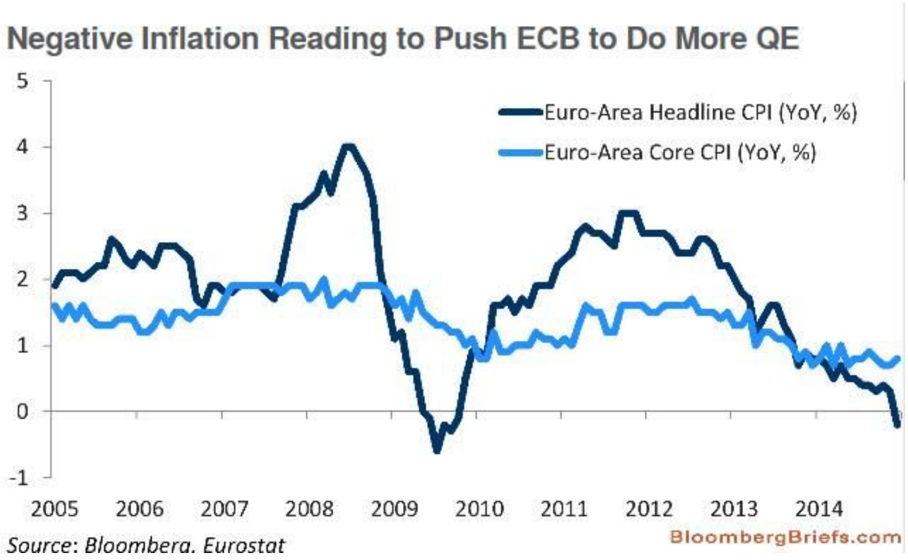
From the Editor

Italian General Director point of view

Price sinking continues this year, as shown in the below chart (Source: Bloomberg, Eurostat). This reduction may impact ECB monetary policy, being an assist for the Quantitative Easing policies that, more than ones, the Governor Mario Draghi, told to be ready to apply. Deflation seems a likely scenery for the Euro zone.

What kind of interesting hints will offer us markets in 2015? I wish good "Points of View" to everybody.



Gianluigi Montagner

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Main scenario Hypothesis

Growth and Inflation

American economic growth continues to show firmness, which is backed up by a monetary policy that is still growth-oriented in terms of interest rate levels, despite the Fed's ending of QE. Expected growth for 2014 is still 2.30%, according to current consensus data. For 2015 expected growth is 3% and for 2016 it is 2.80%. inflation expectations are now at 1.70% for 2014, in line with the Fed's target, since it, like the ECB, is aiming for inflation close to but below 2%. At present, expected inflation for 2015 is at 1.50% and for 2016 at 2.20%. The expected unemployment rate for all of 2015 is at 5.50%, and for 2016 is at 5.20%. For a few years now, during the earnings season the results announced by companies have systematically beaten the consensus view on an overall basis; this divergence results in a steady rise in profits, with the outcome that share prices are not overvalued. Thus the conditions for a continuation of rising American share prices are still in place, at least for the first half of his year. The crucial point at issue is when the new phase of rising interest rates will be initiated by the Fed, as that will have a negative impact on American and world share markets. The consensus view 'sees' this event happening between mid-2015 and early 2016. Our focus is on the third quarter of 2015.

Within the Eurozone, the situation differs between single countries but, considering the Eurozone as a whole, the prospects for recovery are uncertain. For 2014, the consensus figure for growth now stands at 1.80%, well below its potential. Expected growth for 2015 is currently at 1.10% and for 2016 at 1.50%. The definitive inflation figure for 2014 was 0.44%, far below the ECB target fixed at just under 2%. Expected inflation for 2015 is now estimated to be 0.66%, and for 2016 it is 1.30%. Unemployment is still running high – expected to be 11.30% in 2015 and 11.10% in 2016. Besides the expectation of the effects that will derive from the financial stimulus measures announced by the ECB last June, there are now much higher expectations of a strong form of QE arising from the purchasing of corporate and government bonds. This policy will be hard to implement, and will be very burdensome to the ECB in terms of its cost and of creating risks within its budget, so incurring the strong hostility of the German component of its Governing Board. It will however, have a strongly positive impact on markets, and will guarantee the continuation of rising stock markets for at least 12 months.

Assessing the effects of QE on the economic picture in Europe is a different, far less predictable matter, because there is a growing need for the policies of single member states to include radical, urgent measures, especially structural reforms, as Draghi has been pointing out for years. If such measures are not implemented or are further postponed, QE will probably turn out to be no more than a futile attempt to buy time that will only be squandered politically, without leading to any solution of current issues. In that case, the scenario for the very long term (in other words, going beyond the time horizion that includes the positive effects that will be generated by QE) would look more and more disquieting.

In any case, considering that QE is by now almost taken for granted, and considering too the positive impulse that is being given to the American economy and stock indices, along with the changes in monetary policy that are now expected from the Fed, plus the situation of objective undervaluation of the prospects for European firms on the hypothesis of a stable situation, it has never been easier to predict a bullish medium- and long-term outlook for stock markets in Europe, together with the sequel – a positive impact on global markets.

Monetary Policy

The ECB is about to take on the Fed's previous role of directing a growth-oriented financial policy to be implemented worldwide. Now that the Fed is increasingly distancing itself from its previous monetary policy targeted on expansion, which had lasted for years, within Europe the ECB, motivated as it is by facing a general picture that is still far from reflecting the ECB's own objectives, has now begun to apply, and is going to continue to deploy, conventional and non-conventional policies.

To sum up: the Fed's monetary policy still remains growth-oriented, but it now has a bias towards tightening.

The ECB's monetary policy is targeted on growth, while its bias is likewise towards growth.

Stefano Bagnoli
Market Analysis Unit

FED's monetary policy is still expansive,
with restrictive bias.
ECB's monetary policy is still expansive,
with expansive bias.

A year moving at two speeds

The beginning of a new year is always a good time to sum up situations, make forecasts and develop projects. Everyone is saying that 2015 will be an important year – by now it is taken for granted. But 2015 promises (or threatens) to be a turning point, especially for financial markets.

This will be another year in which the main market mover will be the monetary policies of the Central Banks, which are set to reveal a divergence between the two most important of these banks. There is, in fact, an element of continuity in the role that is being transferred from the Fed to the ECB in directing an expansive monetary policy on a worldwide scale. While the Fed is more and more clearly distancing itself from a growth-oriented monetary policy that had lasted for years, within the Eurozone the ECB, spurred on by a general picture that remains far from its objectives, has begun to implement a series of conventional and non-conventional financial instruments. The Fed's monetary policy remains growth-oriented, but it now has a bias towards tightening, while that of the ECB is growth-oriented too, but its bias is likewise expansive.

This will be the year of the first QE to be applied by the European Central Bank.

The ECB's first ever QE will be hard to enact, and it will be very burdensome to it, both in terms of outlays and in terms of risks that will weigh on its budget; for this reason it will be fiercely opposed by the German members of the ECB's Governing Board. Even so, it will have a strongly positive impact on markets, and will guarantee a continuation of the rising trend on stock markets for another 6-12 months. On the other hand, its impact on the business economy is hard to predict – so much so that, without the enactment of the structural reforms that governments are being asked to implement, it is likely to become a futile attempt to buy time that will, anyway, be squandered politically, and will not lead to a solution of the problem.

2015 will also be the year in which the Fed, after pulling the US out of its crisis and, therefore, after achieving that goal, might begin a new cycle of interest rate rises. The time window that is open for this new phase of the American economic cycle is the second half of 2015, while our personal view is focused on Q3.

The initiation of rising interest rates will partly depend on the scenario that will be visible at that moment, and on how that scenario will be communicated, but there is no doubt that the natural thrust of its impact will be bearish. Potentially, at least, it will be an event that has the makings of a turning point, after seven years of rising markets, and it might be followed by a major correction. The precise nature and severity of that correction will depend on many complex factors, in many cases interdependent ones, which we will have to assess at the right ime.

2015 will therefore be distinguished by two fundamental

events in the sphere of monetary policy – events whose impact will point in opposite directions, and which are likely to create two scenarios of divergent types.
Early in 2015 the major event will be the ECB's QE, and the market direction will be upwards. There will be a waiting phase, marked by indiscretions, ambiguous declarations and denials, depending on the way the economic picture develops – whether it moves QE closer or farther off – and all of these events will be amplified by the usual vortex of speculation.

Data that indicate a low level of inflation create conditions in which QE becomes necessary; likewise, when unemployment remains steady at a high level and the price of crude oil is falling, those factors make the immediate introduction of QE more likely. By contrast, data that indicate economic growth, and a rise in inflation and employment, a rising price of crude oil, and the presence of particularly serious systemic shocks, especially those that are geopolitical in nature, are all factors that will tend to favour a later introduction of QE.
It is worth noting too that the monthly figure announced on January 7th indicating the trend of inflation for December 2014 was actually negative at -.20%. That is certainly a figure that brings QE closer.
Markets will move accordingly. To the extent that QE is seen as imminent, that will favour rising stock markets and a fall in the Euro/Dollar cross-rate, whereas a more distant QE will mean a falling trend in stock markets and a rise in the Euro/Dollar exchange rate.
The first major event that could upset market expectations about QE is the early general election to be held in Greece. If it is won by the radical left Syriza party, that could ruin the austerity plan that is slowly bringing Greece closer to a normal economic and financial situation. It could revive a mood of deep anxiety about Greek public debt and bring about steep deflation, while making interest rates soar. All of these factors would translate into a risk premium for Greece well above current levels.
Considering that QE should comprise ECB intervention involving the purchase of government bonds in Eurozone countries that are in difficulty, in theory including Greece, any serious political crisis in Greece would entail a suspension and remodulation of QE that would take weeks of secret negotiations between members of the ECB Board and between Eurozone governments.
So far there is no sound reason for taking seriously the groundless claims made by a number of analysts and media sources that talk of a Greek exit (a 'Grexit') from the Eurozone. All that is impossible, and the long road to a united Europe will continue to be built, even if among many difficulties, but the very fact that people talk about these matters helps to weaken stock markets and, obviously, the Euro itself. It is worth recalling that, to be able to carry out its intrinsic functions, a currency absolutely requires universal, indisputable recognition of its role, so that it can act as a gauge of value, and to be able to maintain that role over time and worldwide. At present, the Euro, while it is potentially the leading alternative to the dollar as a world currency, does not possess that basic requisite!
2015 is set to be another year dominated by political tensions, arising from a considerable number of war zones (of these, Ukraine, Syria and Iraq are the most important, but the many other wars being fought in Africa and elsewhere throughout the world should not be overlooked), nor should the grim return of terrorism. Geopolitical tensions make their contribution to the 'R factor', which is indicative of the risk premium, by raising the structural value of the formulas used to measure the fair value of stocks.
All these factors will contribute to making 2015 a year of volatility on markets. Early 2015 (January and perhaps February too) will be affected by expectations about QE, but the second half will be similarly volatile, especially the summer months, because of expectations that the Fed will raise interest rates. As already mentioned, that event could initiate a reversal of the medium- and long-term trend by the end of the year. This whole issue can be simplified as follows.
If the strength of the rising trend generated by the ECB's QE, together with the media impact of its initial announcement and its successive developments, combined with all the positive economica and financial elements that could derive from that announcement (such as the continuation of the path to growth that is unfolding in the American economy, and recovery in the Eurozone) – if all those events happen and predominate over the bearish influence exerted by the raising of interest rates by The Fed, markets will continue to rise, and for even longer than the 6-12 months I have indicated above. If not, 2015 could become the year of a change in direction. That would mean the fateful begining of the market fall that is feared by many, that has been predicted by some commentators and evoked by others for years. The crucial challenge will therefore be how to correctly model the confrontation between the effects of these two opposite but epoch-making events. All the rest, for now, only functions as a framework.

Stefano Bagnoli
Market Analysis Unit

Secondary Scenario Hypothesis

In January, markets will move within the following forecasting limits.
Up to Thursday, 22th January, markets will be held hostage to high volatility, and will show a bullish (or a bearish) trend, according to how estimates, opinion polls and statistical findings create expectations of a weakening (or a strengthening) of the extreme left (Syriza) and, therefore, a fall (or a rise, respectively) in the probability of the worst kind of outcome.
The ECB Governing Board will carefully review the Greek scenario. If the chances of a victory of the extreme left are high – close to or above 50%, – Draghi will not announce QE, and will simply repeat that the scenario is being continually monitored, while the ECB is ready to intervene at any moment, and he would reiterate that the conditions required for an intervention are already in place. In that case, supposing that the ECB board takes no clear position on the possible non-victory of Syriza, fears might arise about a new anti-European drift and, above all, of the new Greek government deciding to step back from the austerity rules imposed by Europe to ensure the financial survival of Greece and its compatibility with the European system; in that case the ECB would refrain from announcing QE. The tones of the announcement would be such as to make QE sound possible and already clearly defined.. Draghi might even announce QE as being imminent, but without mentioning any date. In that case the markets might resume their falls in an insistent way. Moreover, during the next weekend, if the electoral results were favourable to Syriza, the fall in stock prices would inevitably resume. At that point it would become important to evaluate the declarations of the new majority, which, in any case, in its electoral programme does not speak about an exit from the Euro, but only about different ways of managing the public debt. If the new guidelines of the government turn out to be extremist, that would keep the markets (especially those within the Eurozone, in the first place those situated on its periphery) in a state of severe uncertainty, with frequent episodes of sudden falls in prices. In that case it would become difficult to formulate a forecast without making continual assessments and reassessments.

On the opposite hypothesis of softer tones from Syriza and a willingness to engage in dialogue, the markets will slowly resume their upward trend. On January 28th the Fed will have nothing new to say. In that case the ECB will announce QE on March 5th.
If, however, there is a reasonable certainty that the extreme left will not win the election, which would make it impossible for Syriza to lead the country and bring a new anti-European government to power, the QE will be announced on Thursday 22nd January. With that kind of development, the reaction of the markets will be strongly bullish. In that case, unless there is a surprising misassessment by the ECB of the Greek polls, the most likely outcome of the Greek general election would be more market friendly. If that happens, the bullish shockwave caused by the announcement of QE would be followed by a further bullish input generated by the Greek election result.
Our scenario of the alternative outcomes is a 60% chance of the first option – a conditional announcement of QE, without any indication of its timing, or at most an announcement made as late as March 5th – and a 40% chance of the second option (QE immediately).

Stefano Bagnoli
Ufficio Studi AVM

Markets

The dominant bullish medium- and long-term trends seen worldwide in stock markets are still unchanged. This is a risk-on market: money is flowing from no-risk towards risk and, therefore, from risk-free bonds to equity markets, while favouring growth-sensitive sectors such as banking, finance, technology, the automotive industry and industrials in general. So too, money flows are moving from less growth-sensitive investments to more growth-sensitive ones.

The fall in the price of crude oil is continuing. The WTI variety could bounce back from these levels, supported by a stock market recovery, but if a negative mood returns, the target level for crude could fall as low as $40.

The strengthening pf the US dollar against the Euro has become persistent, with a cross-rate that during the latest sessions reached a new minimum of 1.175.

The strong divergence between the scenarios arising from the opposite monetary policies being implemented by the two main central banks (the Fed's withdrawal from a growth-oriented policy is reinforcing the dollar, whereas the expansive monetary policy of the ECB is weakening the Euro), in parallel with the sharp difference in growth rates between the two economies, continues to strengthen the fundamentals in favour of the dollar and against the Euro. At the same time the greater rate of expansion of the monetary mass in the Eurozone and political tensions in Greece both help to transfer inertia towards Europe. This alignment, almost of textbook type and technically almost perfect, of the causes (i.e. of the reasons that move the cross-rate) is bound to determine a medium- and long-term rise of the dollar against the Euro.

A possible short-term target is 1.15, while the long-term target is parity (1:1). After reaching this second target, the downtrend could continue till it reaches 0.90, which was where it stood soon after the creation of the Euro as a single currency.

Market Analysis Unit

Medium-Long Term Focus

The trend of medium-long-term in the equity markets remains bullish, and the flows ranging from no risk to the risk, and then from the bond, from the areas no risk and defensive currencies (as JPY and CHF), to the stock, areas and growth-sensitive currencies (such as AUD and GBP).

Short Term Focus

The short term trend has returned bullish. The flows ranging from no-risk to the risk, and then from the bond risk free to the stock, and from the defensive currencies towards the growth sensitive.

Economic Highlights

USA

	2007	2008	2009	2010	2011	2012	2013	*2014*	*2015*	*2016*
REAL GDP (YoY)	1,80	-0,30	-2,80	2,50	1,60	2,30	2,20	*2,30*	*3,00*	*2,80*
INFLATION (YoY)	2,87	3,85	-0,35	1,63	3,17	2,08	1,48	*1,70*	*1,50*	*2,20*
UNEMPLOYEMENT RATE (%)	4,62	5,80	9,28	9,63	8,93	8,08	7,35	6,15	*5,50*	*5,20*
FED FUNDS RATE (%)	4,25	0,25	0,25	0,25	0,25	0,25	0,25	*0,25*	*0,95*	-

Eurozone

	2007	2008	2009	2010	2011	2012	2013	*2014*	*2015*	*2016*
REAL GDP (YoY)	2,90	0,40	-4,40	2,00	1,60	-0,70	-0,40	0,80	*1,10*	*1,50*
INFLATION (YoY)	2,13	3,28	0,30	1,61	2,70	2,50	1,34	*0,44*	*0,60*	*1,30*
UNEMPLOYEMENT RATE (%)	7,53	7,58	9,55	10,10	10,12	11,30	11,95	*11,60*	*11,30*	*11,10*
ECB RATE (%)	4,00	2,50	1,00	1,00	1,00	0,75	0,25	*0,05*	*0,05*	-

Italy

	2007	2008	2009	2010	2011	2012	2013	*2014*	*2015*	*2016*
REAL GDP (YoY)	1,70	-1,20	-5,50	1,70	0,40	-2,40	-1,90	*-0,40*	*0,40*	*0,95*
INFLATION (YoY)	2,04	3,49	0,77	1,64	2,91	3,31	1,31	*0,20*	*0,30*	*1,00*
UNEMPLOYEMENT RATE (%)	6,11	6,78	7,82	8,42	8,41	10,68	12,21	*12,70*	*12,80*	*12,55*
ECB RATE (%)	4,00	2,50	1,00	1,00	1,00	0,75	0,25	*0,05*	*0,05*	-

World

	2007	2008	2009	2010	2011	2012	2013	*2014*	*2015*	*2016*
REAL GDP (YoY)	3,94	1,55	-2,32	3,99	2,96	2,08	2,16	2,43	*2,77*	*3,03*
UNEMPLOYEMENT RATE (%)	6,11	6,36	8,18	8,24	7,88	7,82	7,88	*7,41*	*7,16*	*7,00*

Global Market Overview

	9th January 2015	52 weeks min	52 weeks max
Stock Indexes			
FTSE Mib	18.177	17.555	22.590
DAX	9.648	8.355	10.093
S&P 500	2.045	1.738	2.094
Nasdaq 100	4.213	3.414	4.347
Euro Stoxx 50	3.043	2.790	3.325
Nikkei 225	17.198	13.885	18.031
MSCI World Index			
Benchmark Stocks			
Microsoft Corp.	47,19	34,63	50,05
Apple Inc.	112,01	70,51	119,75
Facebook	77,74	51,85	82,17
Alibaba	103,02	82,81	120,00
Intesa San Paolo	2,276	1,889	2,664
Fiat Chrysler	9,92	6,57	11,27
Forex & Commodities			
€/$	1,1842	1,1817	1,3925
CRB Index	434,50	434,50	504,52
Gold	1223,25	1382,92	1144,28
Brent	50,11	50,11	115,06
WTI	48,36	47,93	107,26
Returns			
T-Bond 10 anni (USA)	1,946	1,94	2,89
Bund 10 anni (Germania)	0,4911	0,445	1,8274
BTP 10 anni (Italia)	1,872	1,735	2,592
Spread Btp BUND	138	119,2	175,7

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