Alpha Value MANAGEMENT

Points of View

Analysis, Research and Texts
by AVM Market Analysis Unit

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From the Editor

Portfolio Manager point of view

First months of the year showed the presence of European Central Bank intervention. After Mario Draghi announcement on Quantitative Easing Plan on 22nd January, market experienced first bond purchases in these first days of March. This event reflected some effects on the euro/dollar exchange rate, sank up to 1,08 level; on the 10Y Bund yield that has become 0,3% and on the BTP-Bund spread that reached almost 96 basis points. Forecasts on main indicators like GDP and inflation showed positive signals for Eurozone.

I wish good "Points of View" to everybody.

Gianluigi Montagner

Main scenario Hypothesis

Economic analysis

US economic growth remains strong, supported as it is by a still expansive monetary policy based on the low current level of interest rates, despite the Fed's now avowedly restrictive orientation for the future. Growth in GNP, quoting from the data included in the current consensus, is now expected to be 3.10% this year, and 2.80% in 2016, in line with the previous data released. Inflation for 2015, to quote the data published in the current consensus, is expected to fall to 0.50%, from 0.85% in 2014, and to be 2.20% in 2016, in line with the Fed's broad target, which is exactly the same as the ECB's, looking for inflation close to but less than 2%. Unemployment is expected to be 5.40% over the whole of 2015 and 5.10% in 2016, in line with the data given in the previous consensus figures. For several years now, the aggregate figures for actual seasonal earnings of US companies have systematically exceeded the consensus figures for analysts' expectations: it follows that earnings growth has continued uninterruptedly, so that stock prices are still not overvalued. The necessary conditions are therefore still in place for a continuation of the rise in US equity markets, at least for the first half of this year. The crucial point at issue is the date of the beginning of the cycle of rate hikes by the Fed, which will have a negative impact on US and global stock markets, which is what the consensus view 'sees' happening in the time window between the middle of 2015 and the beginning of 2016. Our personal view for the initiation of the cycle is focused on the third quarter of 2015, with a preference for the month of July.

In the Eurozone, the situation differs between single countries, including single economic sectors: overall, recovery remains uncertain but shows improvement. Growth for 2015 is expected, According to the data included in the current consensus, growth is expected to come in at 1.20%, followed by 1.60% for 2016, in line with data given in the previous consensus. The definitive figure for inflation in 2014 was 0.44%, far from the ECB's target of a rate close to but less than 2%. Expected inflation for 2015 is now negative, at -0.10%, showing a downward revision; expected inflation for 2016 is 1.20%. The latest figures on inflation showed a further decline, and the estimates for 2015 have been revised downwards, mainly due to the drop in oil prices; on the other hand, estimates for the two subsequent years have been revised upwards, in conjunction with a view that the oil price will rise, and, of course, the assumption of a recovery in aggregate demand. Unemployment remains high: 11.20% is the figure expected for 2015 and 10.90% for 2016, an improvement on previous estimates.

The ECB's QE has already produced – well before starting and even before being announced – significant positive effects on all economic plans based on quantitative logic, whether based on comparisons between countries or on monetary flows, in addition to the dynamics of trust. The sharp depreciation of the euro that ensued is promoting exports and revenues from tourism, but, above all, yields have fallen across the board on all curves, have reduced the cost of servicing member countries' national debt, besides reducing the cost of financing for households and businesses, increasing levels of trust and, as a result, slowly strengthening aggregate demand. All this has created and is creating more favourable conditions for an economic recovery, and for a structural flow of capital to whatever implies expo-

sure to risk. The actual beginning of QE on March 9th will only strengthen this favorable context, and will ensure a continuation of the rise in stock markets for at least another 3-6 months. What remains differentiated between countries and at least uncertain is the assessment of the effects of QE on the economic framework of the Eurozone in the long term. Systemic analysis must highlight the need for more radical measures and the urgency of government reforms in single states to implement structural reforms, as Draghi has repeated for years. And if they were to continue to fail, or to be postponed, the QE will probably become nothing more than yet another vain attempt to buy time; in that case political leaders will have wasted their opportunity and no solution to current problems will be achieved. In that case the long-term scenario (i.e., looking beyond the period within which the positive effects of QE will be felt) will turn out to fall far short of current expectations.
Anyway, considering the effects of Eurozone QE, and other monetary stimulus measures already put in place by the ECB, the continuing pace of economic growth, together with positive market trends in the US, not forgetting the objective undervaluation of prospects for European companies, as long as the geopolitical scenario remains sufficiently stable, a bullish view of the medium term can be confirmed (I would say, at least until the summer) for the Eurozone and for global stock markets. Instead, a different view applies for the long term.

Stefano Bagnoli
Market Analysis Unit

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

Markets

"THERE IS NO ALTERNATIVE TO EQUITIES"

Month after month our forward guidance continues to be realized in every aspect, and our periodic analysis offers a forecast that indicates quite clearly the most likely path forward over the next few months.
At this stage, in conversations between private operators, but also between institutional ones, and in listening to the media in general, you often hear phrases like "The time is ripe to be out of the market", "We are at the market top, stock prices are too expensive", "The relationship between price and profit is historically unsustainable", "We make comments about about how to invest, not about how to place bets". All of them are watching the rise on the monitors with a sense of frustration and anger. They got out too early as the market was still rising, didn’t get back in and didn’t have the courage or the right kind of logic to do it now. They expect a correction. They will enter in large numbers at the next big correction in early autumn, and will finally be happy. Except that it will probably be the beginning of the fall.

The explanation for this operational error lies in the fact that every structural analysis should necessarily be dynamic, if it wants to be effective, because the dynamic is the context that you should be studying.
The general economic situation continues to improve and, with it, the fundamentals of the companies themselves: that is why stock prices have been rising. This increase, it should be pointed out, favours the continuation of the increase in the value of risk assets, but does not yet fully reflect the economic improvements that have already occurred and that have mostly been expected. Stock prices, therefore, are not overestimating the value that is constantly increasing from a prospective point of view. Stock markets, first of all Italian ones, are therefore still undervalued, and these prices that call for buying.
In addition, the constant and generalized decline in bond yields, with many asset risk-free, and so offering parking solutions for capital, like the BCE deposit, which had a negative performance today, eliminates any alternative to stock investment for most decisions on the management of big funds. This trend is set to continue, however, with the onset of QE. For the medium term, therefore, the risk-on stance will continue to dominate. Not only for reasons of value, but also for reasons of money flow and relative convenience.

Stock markets will continue to rise, at least until at least June, then we will update the overall picture. The S&P and Dax are both attacking their highs – the FTSE MIB most aggressively of all. Possible targets for the end of June: 2150 for the Standard & Poors 500, 12,000 and

24,000 for the Dax and Footsie Mib.
The sectors to be preferred are Italian banking and US technology, with an eye for the short term even in the oil sector, which we eliminated a few months ago and which still does not appeal to us for the long term.
Spreads continue to compress, and therefore there is value to be found in peripheral bonds, but also corporate bonds and high yield bonds seem attractive for the short term (if appropriately chosen: European ones yield between 5% and 6%). However, given the strong risk-on condition in this phase, stock investments should be considered more than those in bonds, while respecting the criterion of balance within each personal portfolio.
The euro-dollar cross rate continues its expected bearish acceleration toward the target of 1:1 (parity) and then on to other, more ambitious goals. It is worth remembering too that, just after the birth of the single currency, the euro-dollar exchange rate stayed around 0.90 and hovered for some time near its minimum of 0.8490 reached in June 2001. Well, the systemic conditions were less favourable to the dollar at that time, and less unfavourable to the Euro, than they are today. The differential growth was not as strong as it is today, and there wasn't the current huge gap in the orientation of benchmark central banks' monetary policies: the Fed is removing its monetary stimulus and is about to raise interest rates, while the BCE has been keeping rates near zero for an extended period of time, and is now starting its QE. It stays committed to its effort to the maximum acceleration of accommodating monetary policies. This can be seen in concrete terms in the different trajectories of T-Notes, and Bund curves. This trivial consideration contributes to reassuring expectations of a Eurodollar ratio below parity by the end of 2015.

As part of the general currency picture, the ruble is recovering much of the lost ground lost and will play a major role in the current year.
The price of oil is expected to rise. Our estimates are for a rise in oil prices in the second half of the year to at least $70.
The barrel of WTI crude oil for a few weeks has been making wide swings around the 50 dollar level, after hitting a low just above $44. At this stage the forecast is very diversified. The US Energy Information Administration has warned that prices will remain low because supplies continue to outpace demand, and in fact for many analysts the decline in prices seems to reflect an increase in global stocks rather than a weaker global demand. But in our view there has been a phenomenon of overshooting on prices, i.e. prices have discounted or discarded real reasons in favour of a quick drop, so rapidly falling well beyond an effective and reasonable fair value for the barrel. Not to mention that OPEC will intervene within a few months by dropping its production to support prices. Our estimates are for a rise in the price of a barrel of WTI in the second half of the year to at least $70. (To see the effects of this event, please refer to "Main Scenario Hypothesis").

The balancing by Draghi and the ECB in groping to better manage the Greek farce came close to being heroic. By making a clever marketing ploy into a media issue, both identical in substance, the whole question has been moved

forward for four months, right at the point of intersection with the critical time window of the possible beginning of the Fed tightening cycle. For years the state has issued Greek bonds that were bought by Greek banks with the money from European funding. This game is over, and with it the opportunity to continue to hide the real problem with artifice in its entirety. Greece can never fully repay its debt: that is the truth. The "Greek front" therefore remains able to create instability in the system and to schedule new negative elements for early summer.
The same line of thought can be adapted to the geopolitical context, where many critical issues and areas of risk now face disturbing scenarios, from Ukraine to the increasingly intrusive presence of Islamic fundamentalism in the struggle for control of areas that are rich in oil and/or territories of strategic interest.
However, both the Greek risk and the geopolitical risks worldwide seem to have been resized at this stage. We consider this a temporary improvement and also that soon we will see a new acceleration of the dynamics of risk, but for the moment almost everything seems to be under control. Moreover, the decline in Greece contingent risk and geopolitical risk has resulted in a reduction of the variable risk "R" in the valuation models and in volatility, so helping to bring further strength to the underlying uptrend in equity markets over the medium term.

For the long term, however, we remain of the opinion that after the latter upward acceleration in the first half of 2015, subsequent events will determine the conditions for a downward cycle of a certain duration and consistency (cfr. “Main Hypothesis Scenario”). But for now let’s enjoy the party.

Market Analysis Unit

Medium Term Focus

The trend of medium-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	2017
Real GDP (YoY)	1,80	-0,30	-2,80	2,50	1,60	2,30	2,20	2,40	*3,10*	*2,80*	*2,70*
Inflation (YoY)	2,87	3,85	-0,35	1,63	3,17	2,08	1,48	1,63	0,50	*2,20*	*2,20*
Unemployement Rate (%)	4,62	5,80	9,28	9,63	8,93	8,08	7,35	6,15	*5,40*	*5,10*	*4,95*
FED FUND RATE (%)	4,25	0,25	0,25	0,25	0,25	0,25	0,25	0,25	*0,90*	-	-

Eurozone

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP (YoY)	2,90	0,40	-4,40	2,00	1,60	-0,70	-0,40	0,90	*1,20*	*1,60*	*1,50*
Inflation (YoY)	2,13	3,28	0,30	1,61	2,70	2,50	1,34	0,44	*-0,10*	1,20	1,45
Unemployement Rate (%)	7,53	7,58	9,55	10,10	10,12	11,30	11,95	11,58	*11,20*	*10,90*	*10,50*
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	2017
Real GDP (YoY)	1,70	-1,20	-5,50	1,70	0,40	-2,40	-1,90	-0,40	*0,40*	*1,00*	*1,00*
Inflation (YoY)	2,04	3,49	0,77	1,64	2,91	3,31	1,31	0,21	*0,05*	0,90	0,90
Unemployement Rate (%)	6,11	6,78	7,82	8,42	8,41	10,68	12,21	12,69	*12,80*	*12,40*	*12,40*
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	2017
Real GDP (YoY)	3,94	1,55	-2,32	3,99	2,96	2,08	2,16	2,52	*2,76*	*3,06*	-
Unemployement Rate (%)	6,11	6,36	8,18	8,24	7,88	7,82	7,88	7,34	*7,11*	*6,87*	-

Global Market Overview

	Price as 9th March 2015	Last Month Variation	Year to Date
Stock Indexes			
FTSE Mib	22564,35	1,20%	24,06%
DAX	11582,11	1,51%	22,26%
S&P 500	2079,43	-1,79%	2,91%
Nasdaq 100	4412,99	-1,56%	6,06%
Eurostoxx 50	3610,28	0,53%	19,42%
Nikkei	18790,55	-0,19%	15,34%
MSCI Emerging Markets	959,22	-2,94%	1,97%
MSCI World Index	1741,84	-1,96%	4,22%
Global Hedge Fund Index	1239,85	-0,15%	2,18%
Benchmark Stocks			
Microsoft Corp.	42,85	-2,35%	-7,50%
Apple Inc.	127,14	-1,51%	19,66%
Facebook	79,44	-0,39%	2,91%
Google	574,10	-0,16%	10,52%
Alibaba	82,53	-1,75%	-
Intesa San Paolo	2,99	1,36%	29,38%
Fiat Christler	14,15	0,35%	-
Forex and Commodities			
€/£	0,72	-1,31%	-8,28%
€/$	1,085	-2,84%	-8,92%
CRB Index	219,31	-1,20%	-3,27%
Gold	1167,51	-3,35%	-2,79%
Brent	58,53	1,82%	-1,12%
WTI	50,00	0,83%	-0,08%
Yield curves			
T-Bond 10 years	2,137	-	-
Bund 10 years	0,233	-	-
BTP 10 years	1,221	-	-
Spread Btp BUND	0,988	-	-

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