

Framlington
Equities



Finding winners in an unpredictable world

Chief Economists' Forum Australia

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Finding Opportunity

Differentiate between Alpha and Beta

Don't try and Predict Macro as a source of Alpha

This will lead to a very concentrated portfolio with only one or two 'bets'. This is high risk

Focus on the long term trends driving Alpha at the stock level

Bottom up stock picking has a long term alpha component – focus on the business model, competitive position, disruption, profitability etc. Aim for diversification

Take advantage of Beta opportunities offered by the market in anti Consensus Trades

Buy from distressed sellers, sell to forced buyers. The market will sometimes offer the 'wrong price'

Last Year's Consensus could hardly have been more wrong

Don't try and predict the macro as a source of Alpha

Predictions for 2016*

China to collapse

RMB to decline 40%

Western Equities to fall 20%

Oil to \$16

Buy Bonds

Emerging markets to collapse

Commodity prices to continue to decline

Outcomes

China GDP + 6.7%

China market + 8%

RMB -5% v \$, -1.6% against trade weighted

S&P +23%

Oil \$53 (+69%)

US Treasuries -2%

US high grade bonds +6%

EEM Index + 28%

Ibovespa (Brazil) +62%

Iron Ore +95%

What was missed

— Politics and structural change

Brexit

Trump

Italy

China 2.0

The beginning of the end of QE

From Low Yield To No Yield – the underlying trend

The response from ChiMerica to the GFC moves to a New Phase

China responded to the GFC by stimulating its Real Economy

- ▶ This produced a mis-allocation of Capital due to the inefficient financial system, including bad debts

America responded by stimulating its financial markets (and everyone else's)

- ▶ This also produced a mis-allocation of capital and an over-supply of everything sold into China and a lot of debts liable to go bad – from the Oil patch in the US to emerging markets.

China is building a new financial system suited to the size of its economy

- ▶ The structural change story remains key – most of China is still banking. That will steadily be replaced with Capital Markets. The capital account will open, but not as quickly as some hope/wish.

America (and Europe) are seriously undermining their financial system with their policy mix

- ▶ Trying to stimulate economies that want to deleverage by using monetary policy is almost impossible and not necessary. Meanwhile it leads to damaging carry trades, misallocated capital and ‘Minsky Moments’

Carry Trade unwinds

- ▶ The unconventional monetary policy of the post 2008 period has done little more than stimulate carry trades. Now unwinding

Populist Politics is actually a rejection of these policies

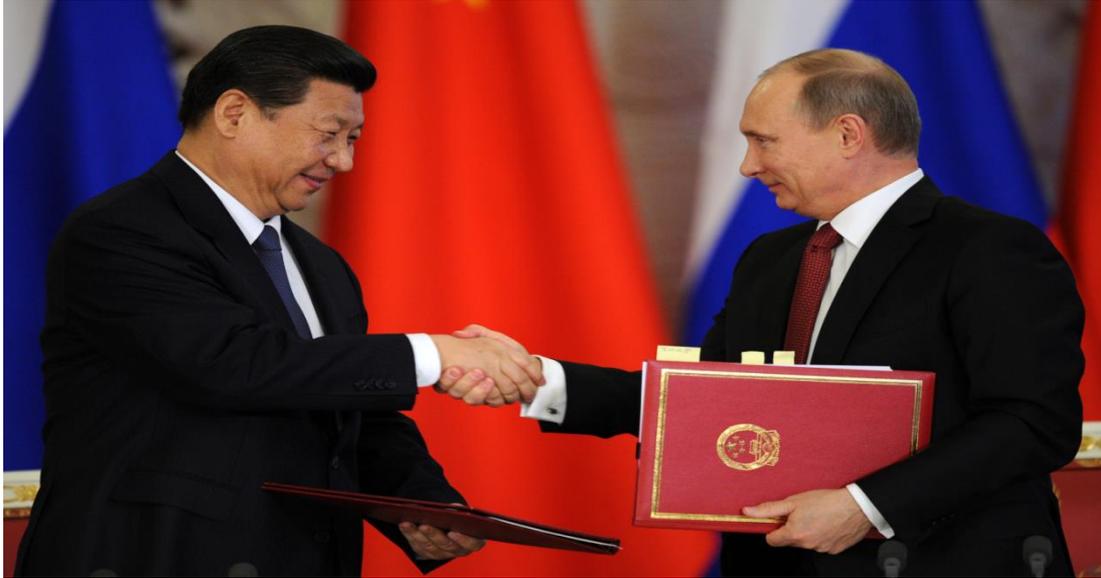
▶ Since the GFC, it's been all about Policy Makers



G7

BRUSSELS 2014

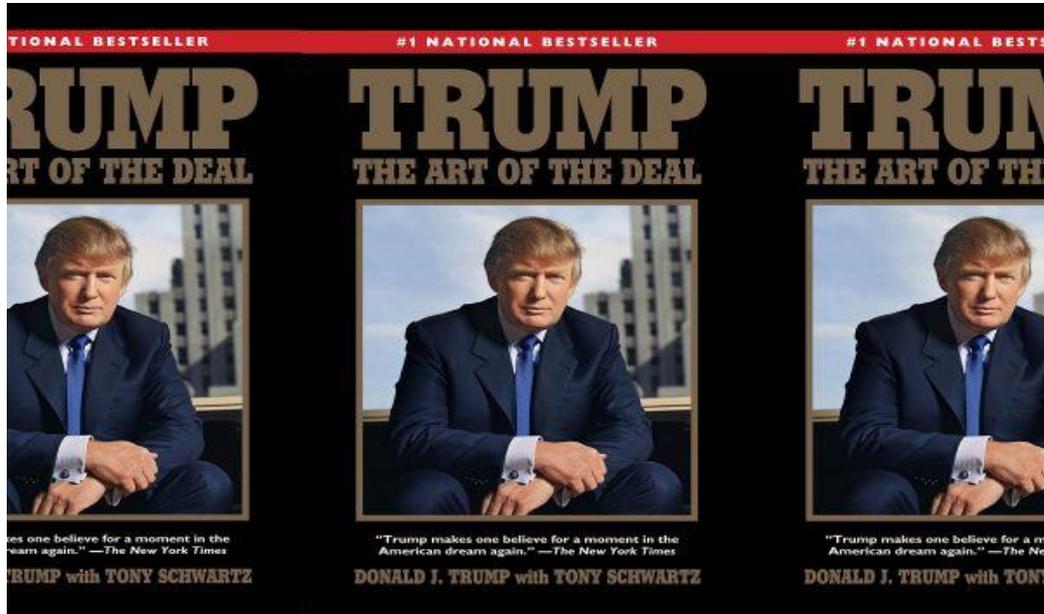






The Art of the Deal

News flow will be dominated by Tweets – structural change by the Deals



- ← President Trump will focus on jobs, growth and Trade
- ← To achieve this he will do deals on foreign policy, deals on corporate taxation and deals with the private sector on infrastructure
- ← The market has probably got ahead of itself in the short term, but the long term story remains a Policy Paradigm Shift
- ← Everything is up for grabs

Trade, Commodities, the \$ and America first

Not likely as bad for Emerging Markets as some think – Anti Consensus Beta Opportunity?

A stronger US Economy is good for demand in EM

Tariff barriers are a negotiating tactic

A strong Dollar is bad mainly if you have unhedged dollar debt – most don't any more.

Consensus is for 'higher inflation and commodity prices – but have we altered Demand and Supply?

Reducing the US Trade Deficit is likely to mean pumping more Oil and Gas – this is good for energy consumers

But....China is as big as Europe – and as varied



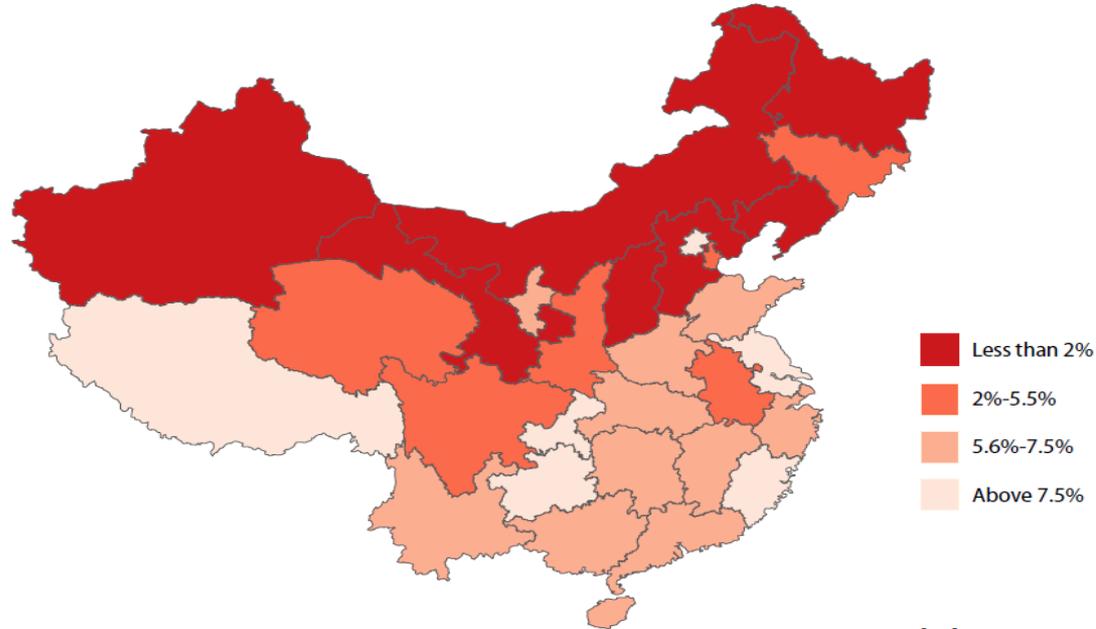
Source: Zero Hedge

An average of 6.5% Growth covers a wide spectrum

Old China is growing at zero and New China is Growing at 12%

Growth is weakest in China's west and north

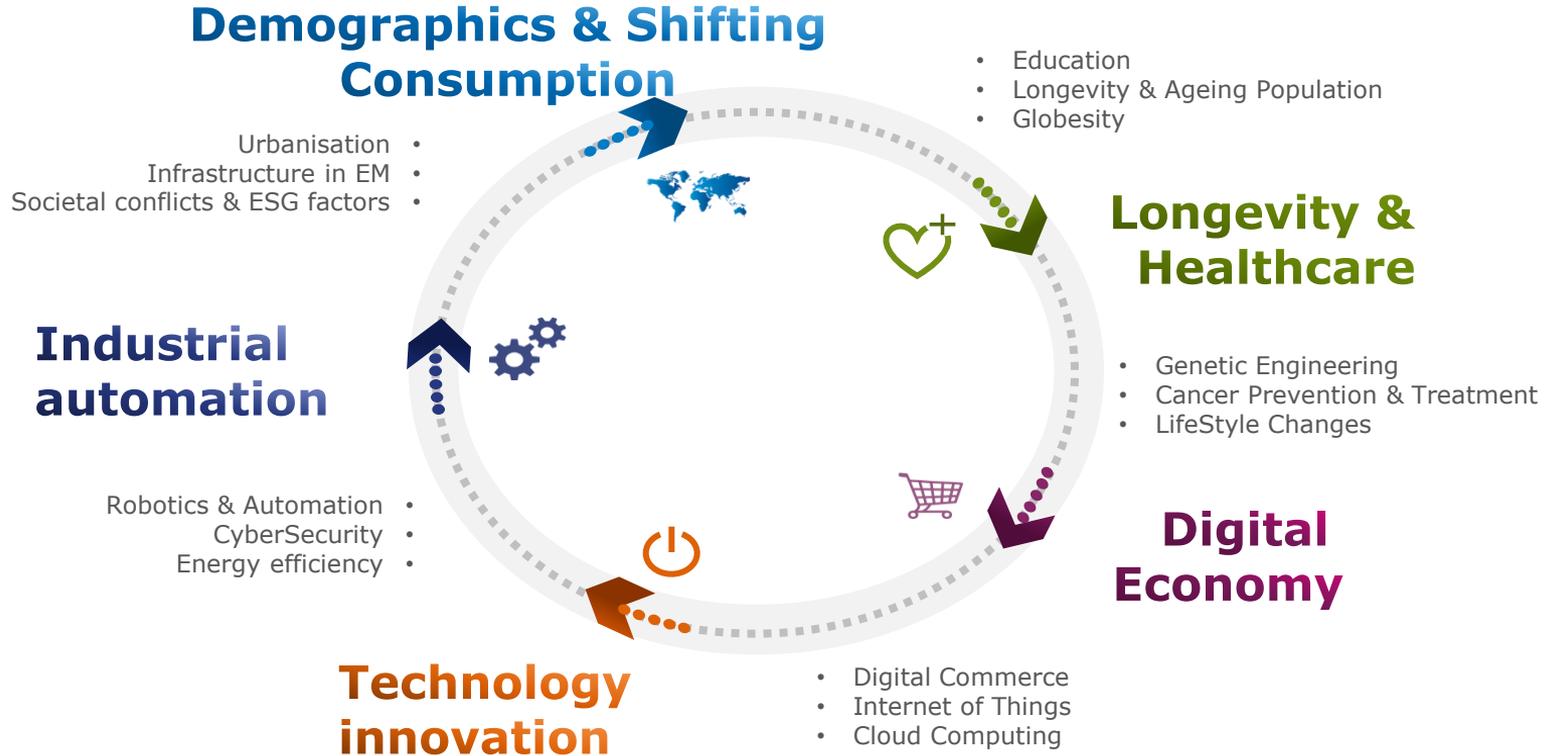
Provinces ranked by nominal GDP growth in 2015



CEIC, Gavekal Dragonomics

Investment themes – Global and Local

Long term investing approach

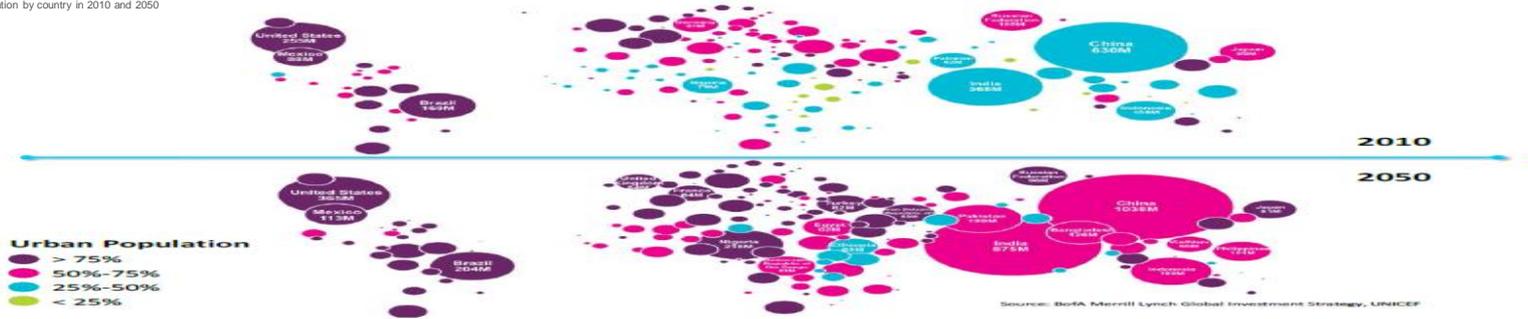


Demographics: Infrastructure needs in Emerging Markets

Materials, Toll-road Operators, Telecommunications, Electrical Systems, River and Railway Stations

Urbanisation

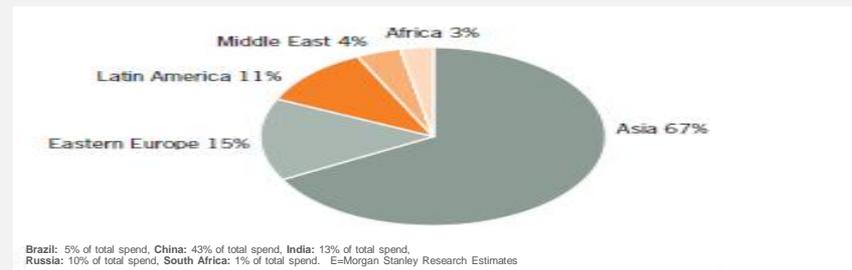
Urban population by country in 2010 and 2050



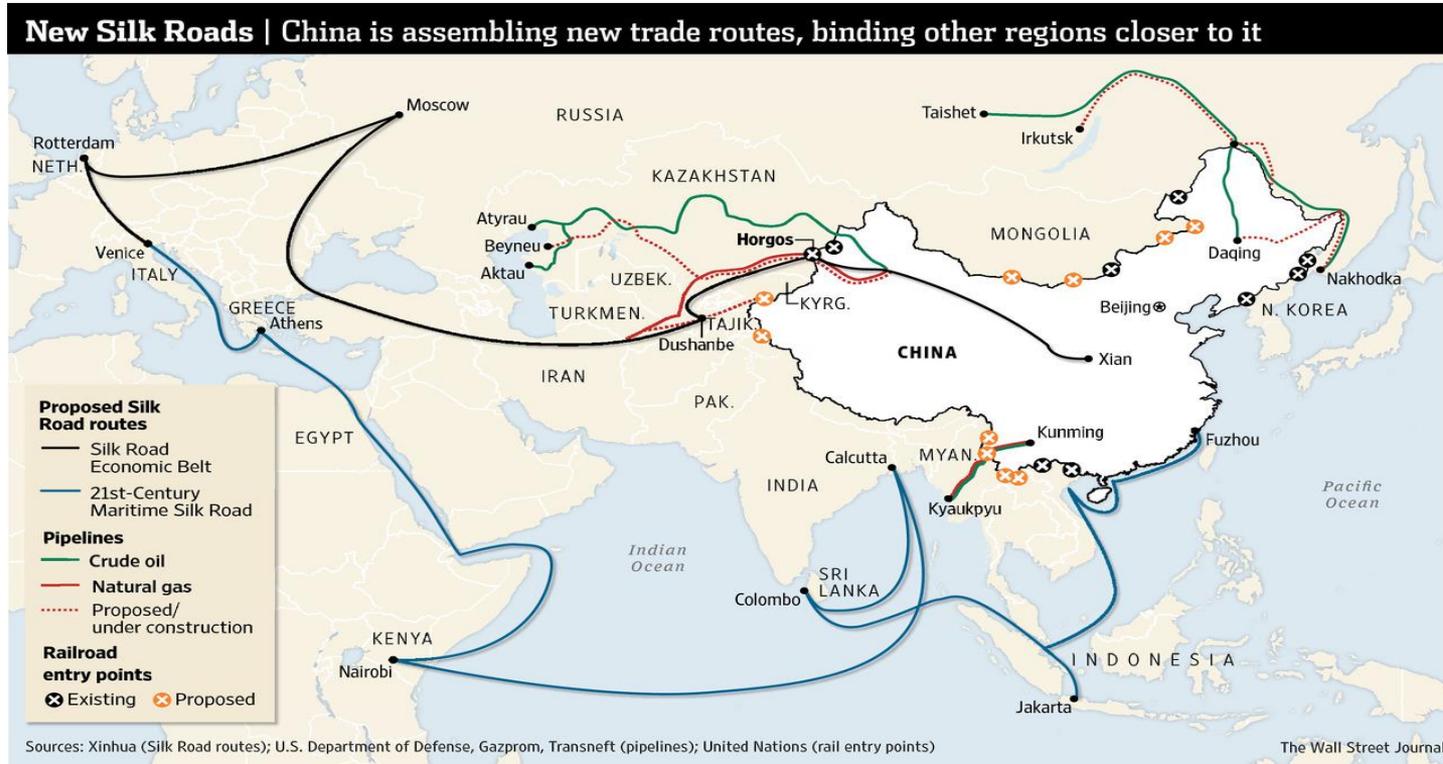
- In the next 10 years, the world's largest 600 cities will comprise nearly 65% of global growth.
- The countries with the greatest urban populations in 2050 will be China (1bn), India (87.5mn), US (365mn) and Nigeria (218mn).
- Urbanisation has huge investment implications for infrastructure in the next 3-4 decades.

- ▶ EM country **populations are growing and urbanizing**, straining existing infrastructure resources
- ▶ Forecast of a **total \$21.7tn in infrastructure spending in EM over the next decade**, with **Asia representing 67% of this total**
- ▶ A surge in market listings of owners, operators and contractors to build EM infrastructure is underway
 - Listed EM infrastructure-related entities has risen from 230 to 354 (+54%), **total market cap is now \$1.1tn**

EM infrastructure spending: 2008-17e – Regional Breakdown



One Belt One Road...driving trade... and investment in Asia



Source: Zero Hedge

Investors need to be real not synthetic – Alpha stories

Asia is where the Growth and the Cash Flow can be found.

The decline of leverage

If we don't recognise that leverage and liquidity are a source of risk, regulators probably will. Structured products relying on leverage will be replaced with 'old fashioned' securitised capital markets products based on cash flow.

Asia is where the growth is

China growth 2.0 will be the main Engine for Asian Growth

OBOR will recycle savings into long term infrastructure investments.

Capital markets will grow in place of banks and shadow banks, offering higher returns to savers and lower costs to borrowers

This can lower very high savings rates, driving economic activity

And where the Cash Flow is

One third of all dividends paid globally come from Asia – yet benchmarks make them only 5% of portfolios.

Corporate Bonds offer long term investors access to cash flows currently 'trapped' in the banking system

Infrastructure Bonds and Muni Bonds offer new products – both as repackaged existing loans and new loan opportunities.

Anti Consensus Trades – possible Beta Opportunities

Watch for opportunities where market consensus offers mis-pricing.

Politics

President Trump will not be as radical as his supporters hope, nor as terrible as his opponents fear – he will do deals

The European project will struggle on, Europeans will not reject policy makers in the same way the US and UK have.

China will continue to build its Financial infrastructure

The UK will exit the EU but it will not be an economic disaster

Consensus shorts

Emerging Markets and countries seen to be 'hit' by tariff barriers

European Banking system

China Banking system

RMB, Mexican Peso, Euro

UK, European Small Caps

US Treasuries

Consensus Favorites

US Financials will benefit from steeper yield curve and lower regulation

Infrastructure plays in the US

\$, Commodity Currencies

Beneficiaries of the 'reflation trade'

Oil, Commodities

US Equities

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