

Investment Strategy Themes

Outlook for Assets, Regions, Sectors & Investment Styles

Khuram Chaudhry
European Quantitative Strategist

Bank of America 
Merrill Lynch

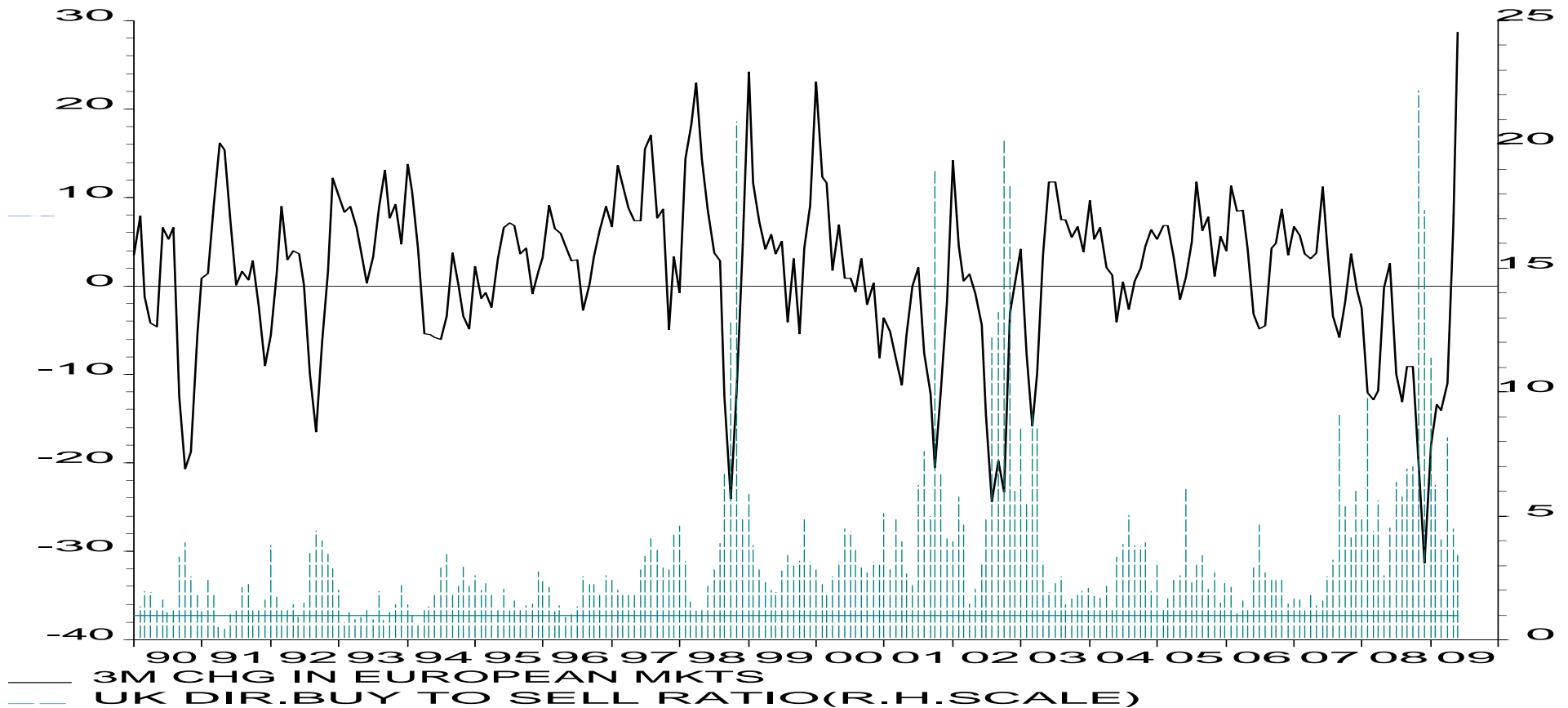
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Investment Strategy Themes

- **Tactically Bullish - the 'Base Effect' rally**
1) ample liquidity, 2) steep yield curves, 3) cheap valuations, 4) depressed equity sentiment, 5) a trough in profits revisions and economic data.
- Significant high risk/ pain trade is starting to hurt investors as financial markets rally. Investors starting to capitulate and buy into an economic recovery.
- **Strategically Bearish - absence of top-line profits growth**
1) output gaps are negative, 2) sales growth/ revisions are being downgraded, 3) the good news on cost control now changing direction (FX, input prices, BY, re-stocking starting to rise).
- Equities are expected to outperform bonds near-term, Non-US Equities to rise more slowly than before. As high risk appetite wanes.
- Small Caps to continue outperforming Large Caps, Value to outperform Growth and a shallow profits recovery to lead to a bull market in High Quality stocks .

Depressed Sentiment

UK Company Directors' BUY to SELL Ratio



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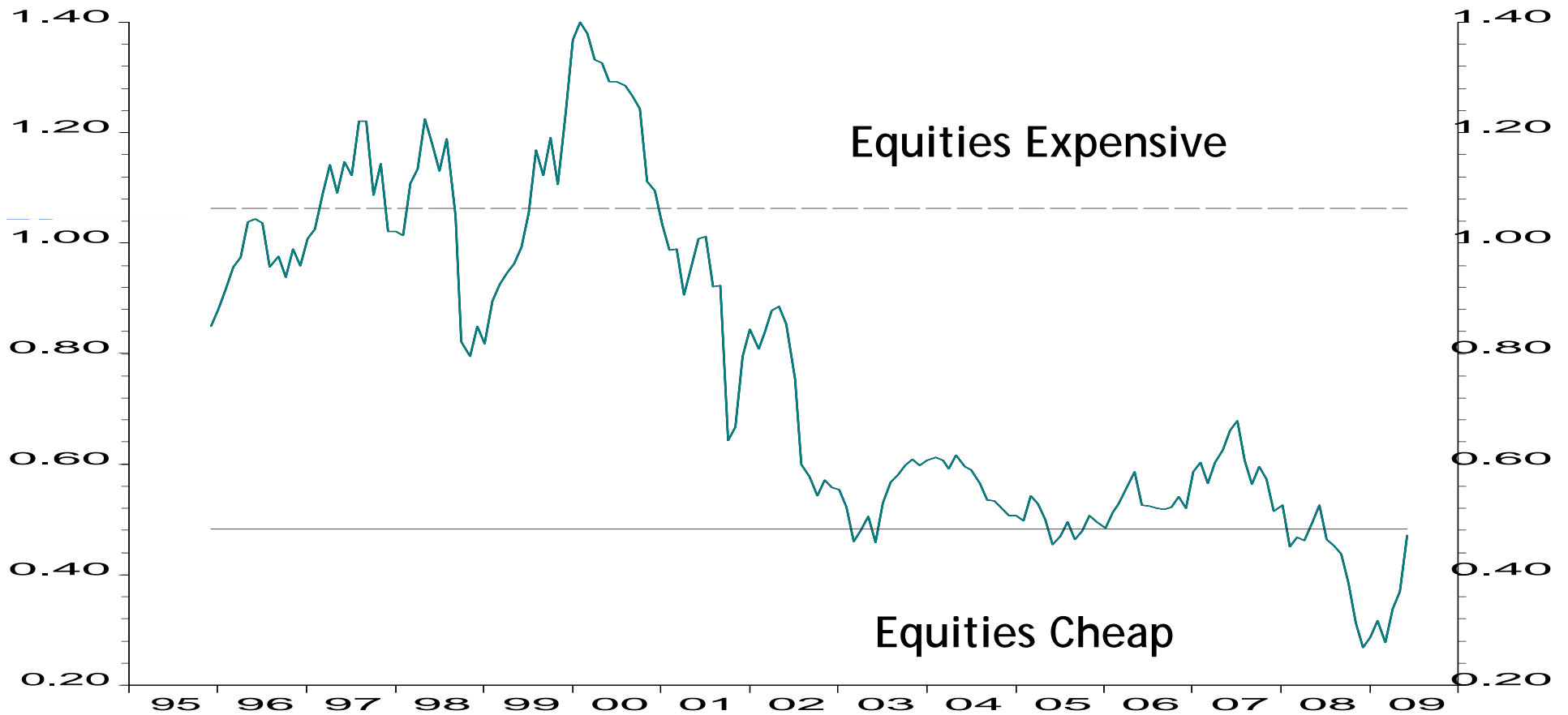
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Source : Bank of America Securities - Merrill Lynch European Quantitative Strategy

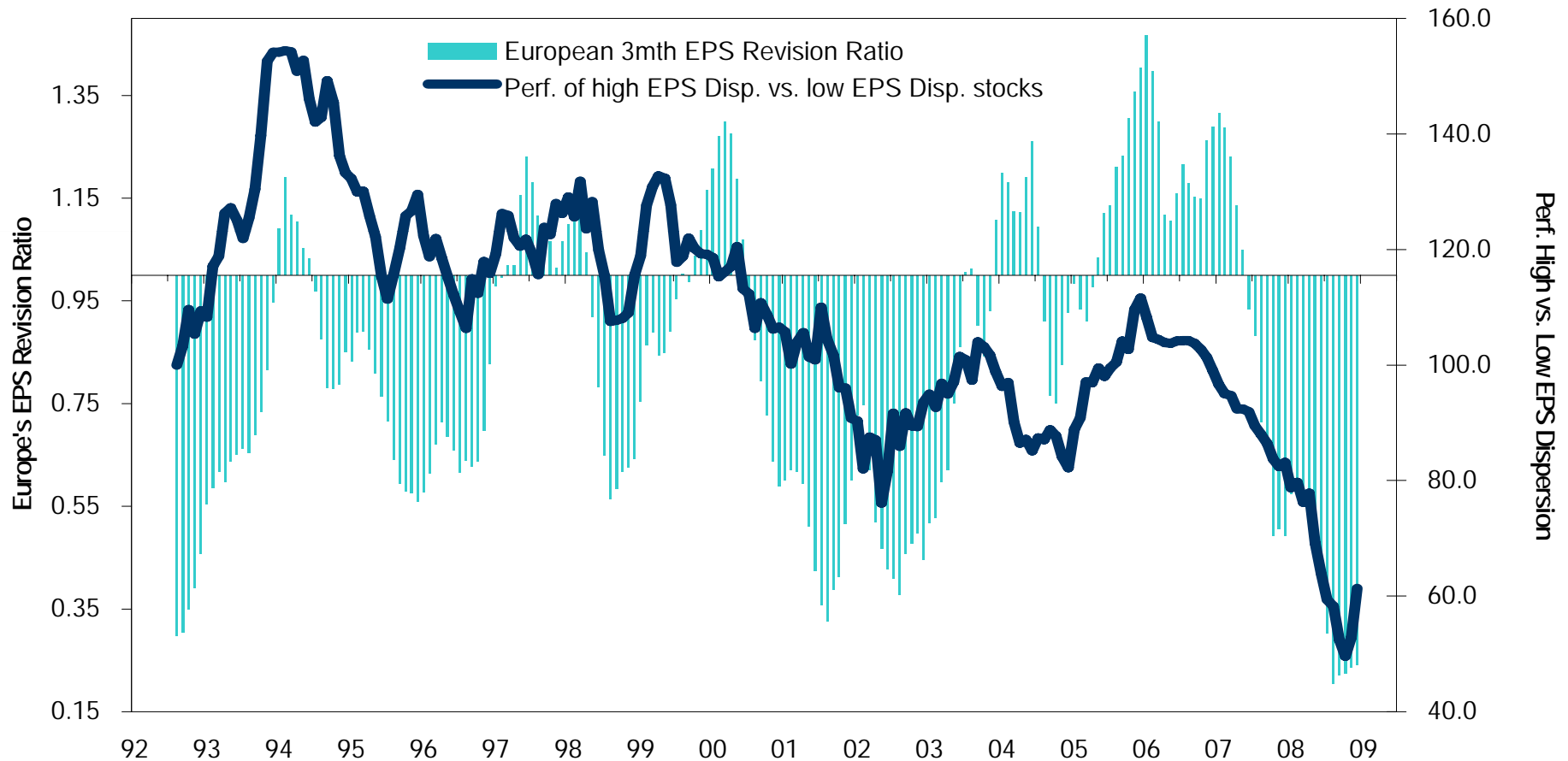
Cheap Equity Valuations

European Bond to Equity Yield Ratio

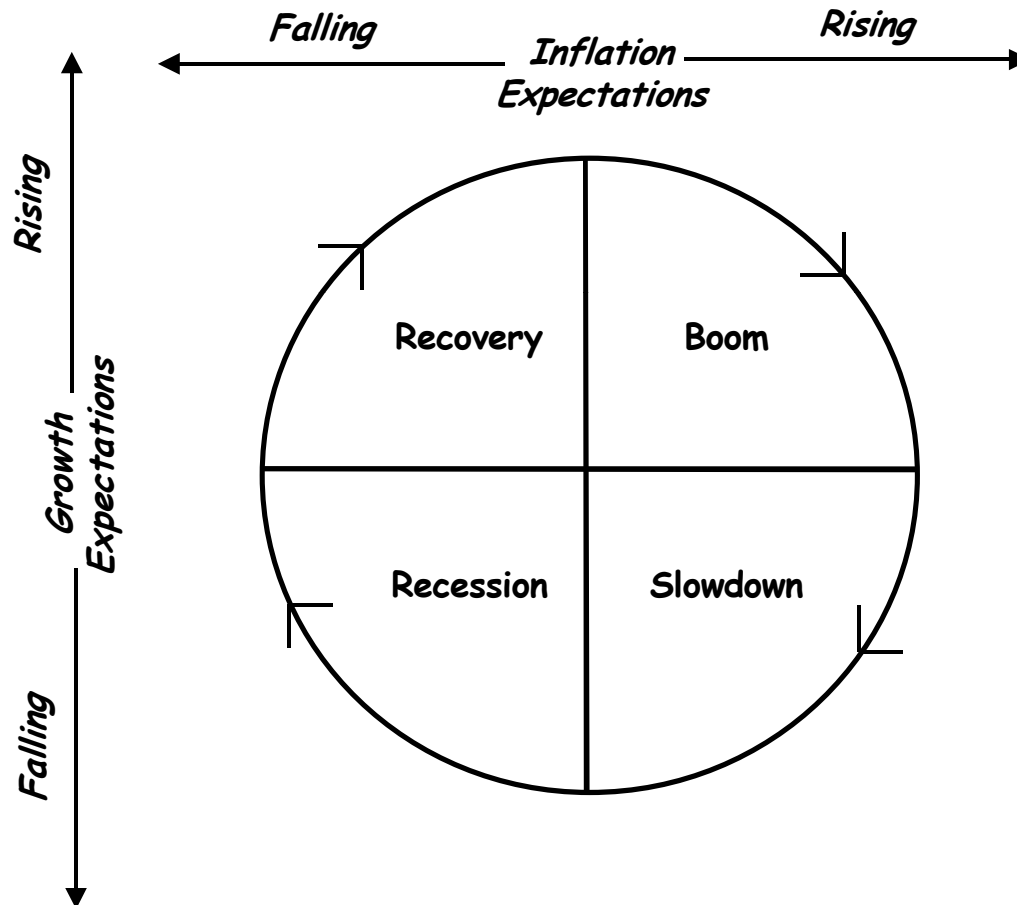


Massive Rise in Risk Appetite

Performance of High vs. Low Risk Stocks and Europe's EPS Revision Ratio



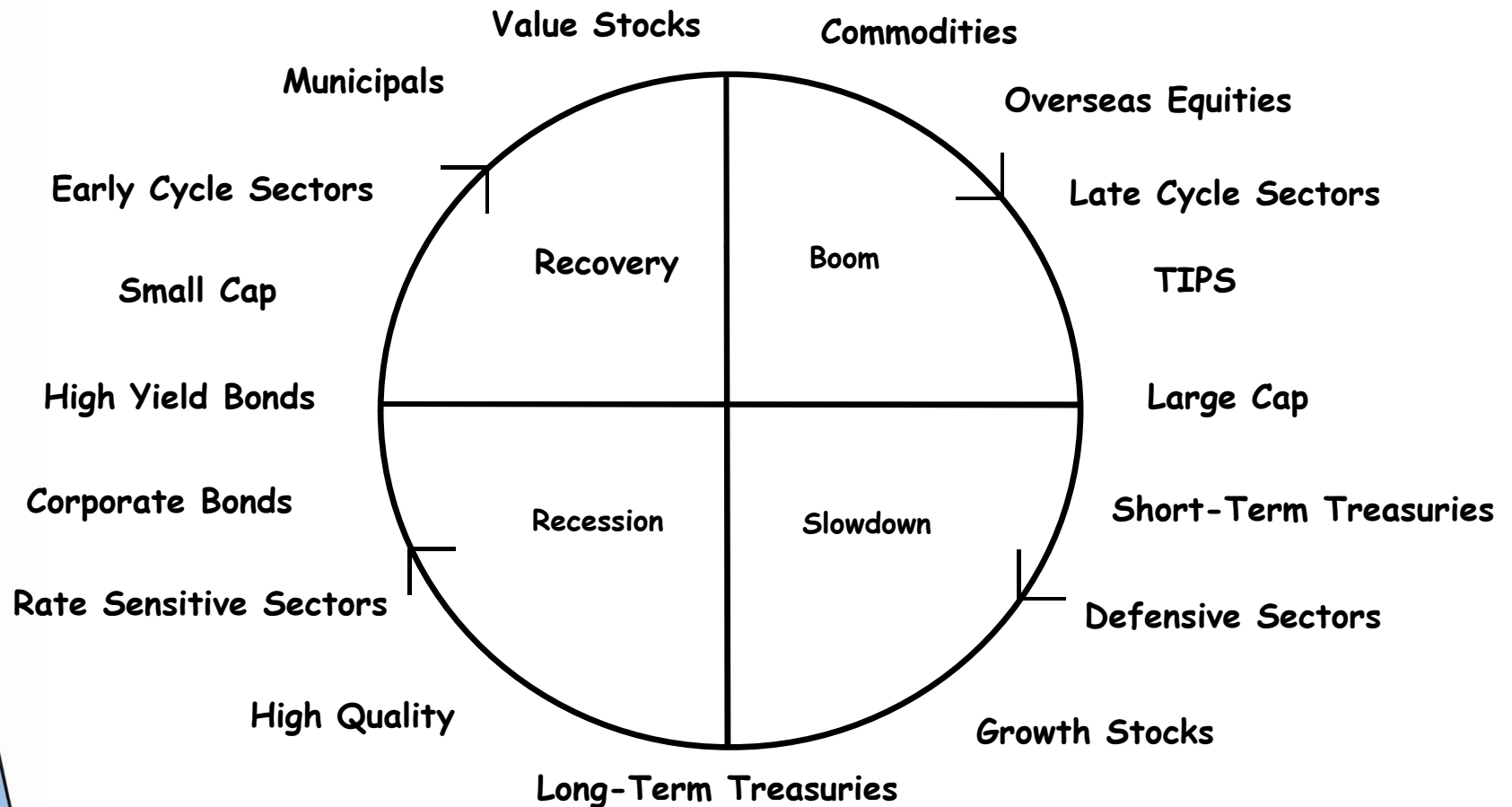
BAS-ML 'Investment Clock'



Investors are hoping we swing from 'Recession' to 'Recovery'

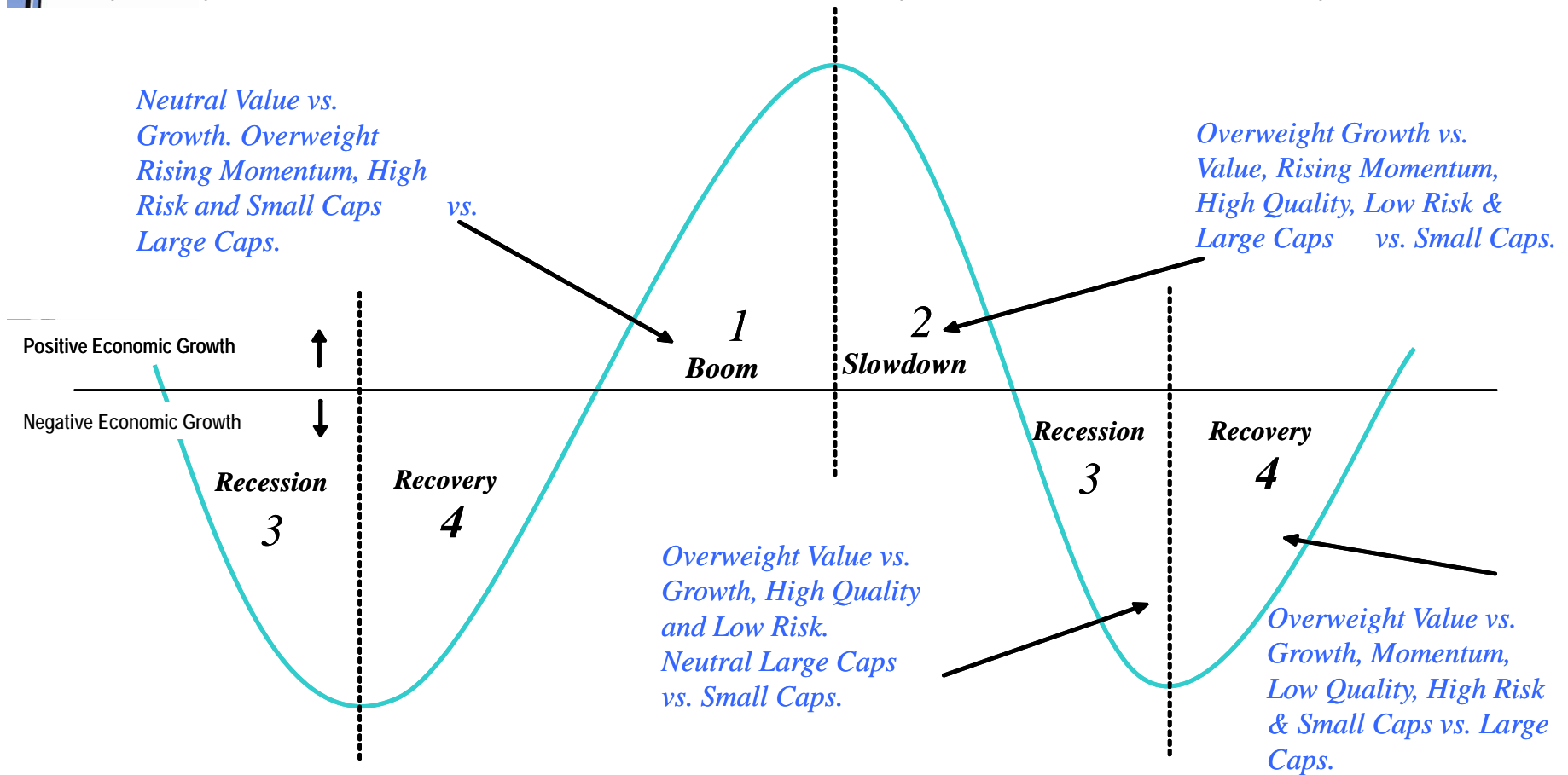
Recovery: the economy improves thanks to easier policies, ample liquidity and an improvement in profits; expectations of faster growth & low to rising inflation.

BAS-ML 'Investment Clock'



European 'Style Cycle'

'Style Cycle marries phases of the economic cycle with Investment Style Price Returns



Phase 1 - Rising & Accelerating; *Phase 2* - Rising & Decelerating; *Phase 3* - Falling & Decelerating; *Phase 4* - Falling & Accelerating.

*Economic Cycle based on the ML Composite Macro Indicator

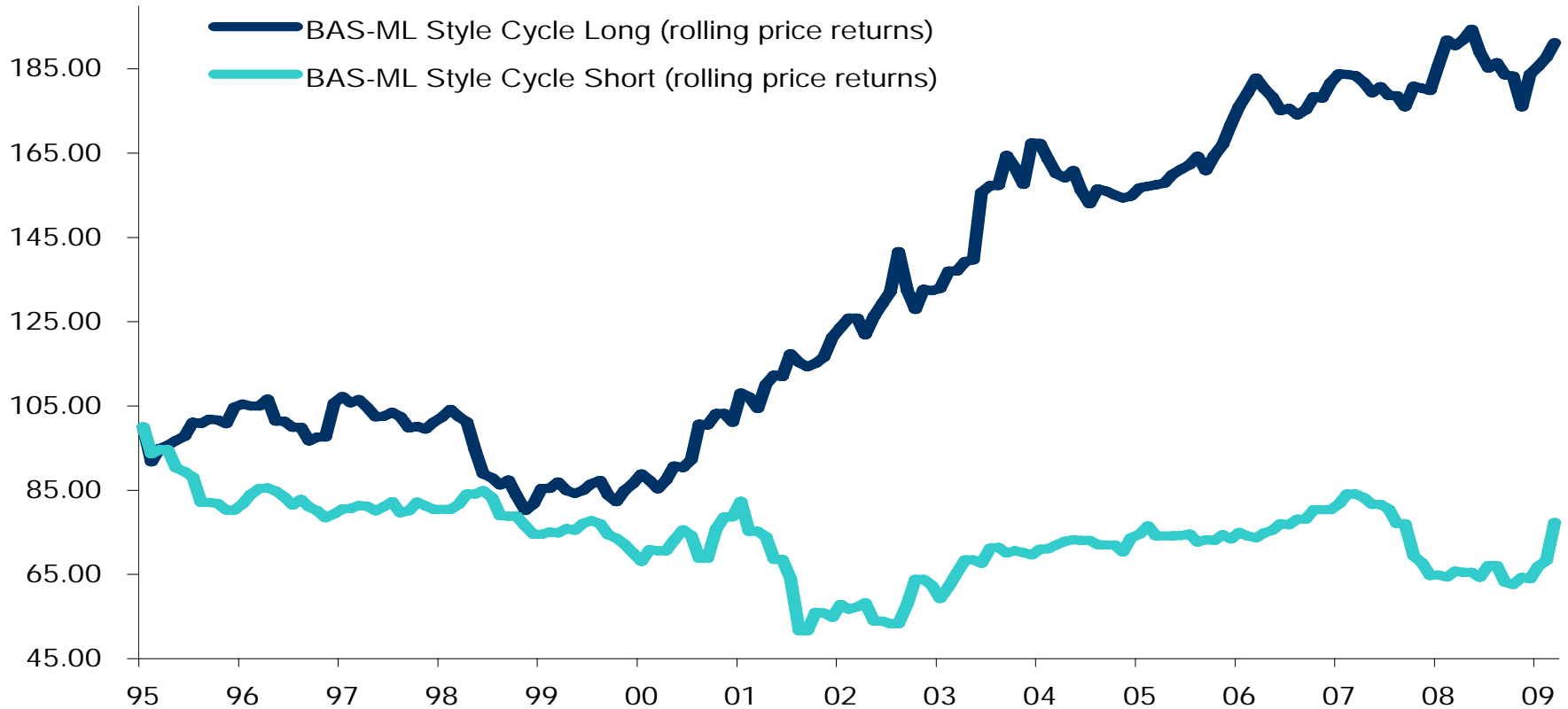
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European 'Style Cycle'

Back-testing the European 'Style Cycle' – rolling price returns from one phase to next



European 'Style Cycle'

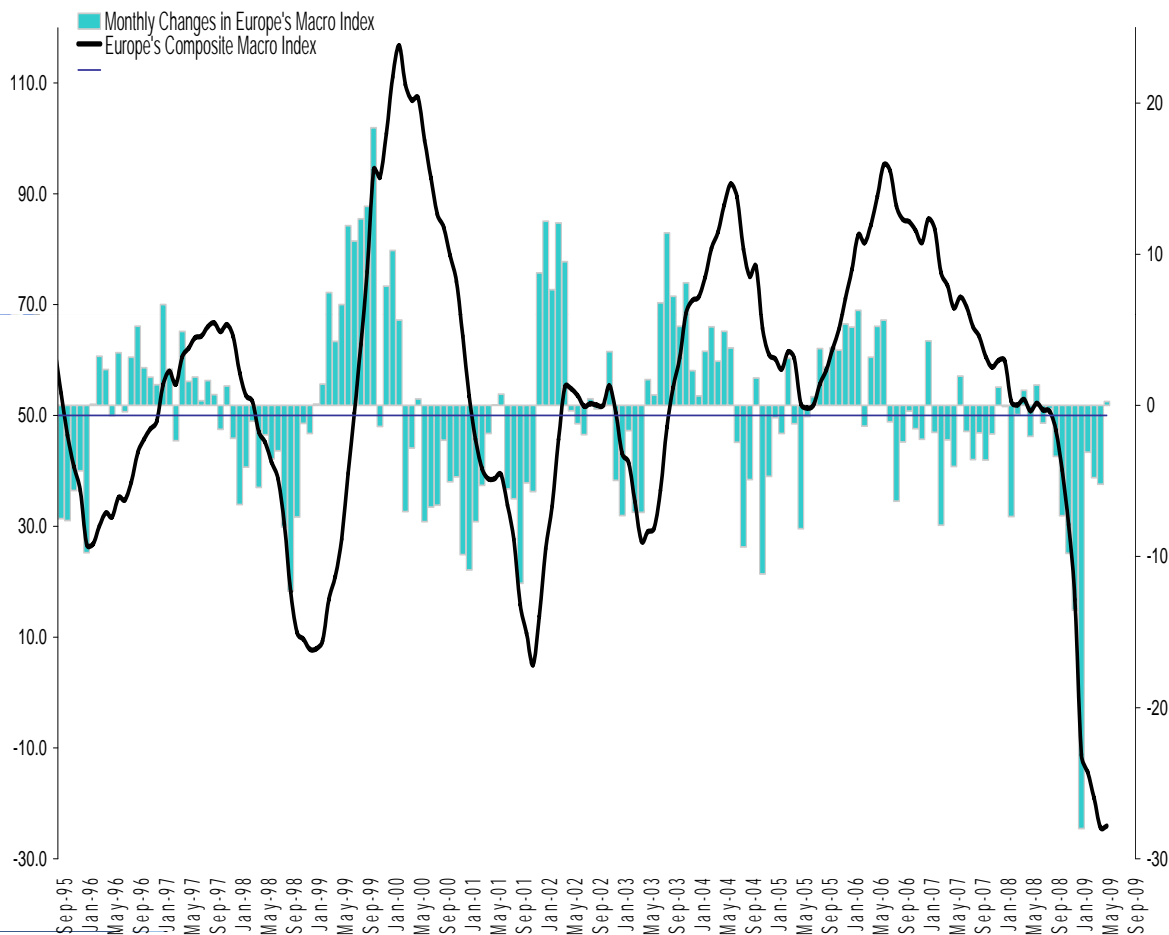


Table 1: Summary Europe's Macro Signals

Inputs of ML Composite Macro Index	Direction
Pan European Cons. GDP Forecasts	FLAT
12mth Change in Pan EU Bond Yield	RISING
Producer Price Inflation	FALLING
OECD EU Leading Indicator	FALLING
German IFO Indicator	RISING
Global Sell-Side EPS Revision Ratio	RISING

Source: BAS-ML European Quantitative Strategy

European 'Style Cycle'

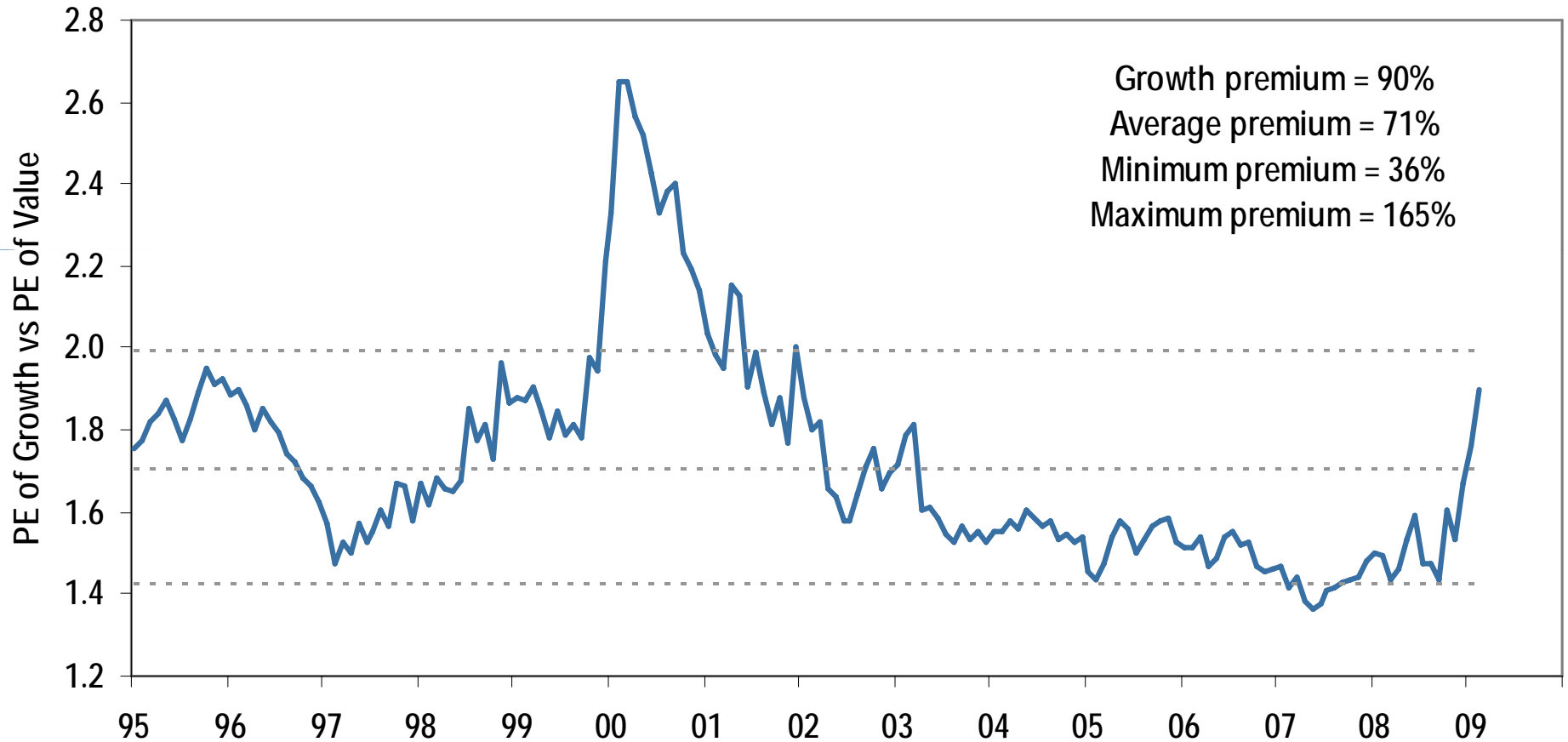
Table 3: Investment Styles – Relative Returns (%) – Prices as of 31/05/09

	1M	3M	6M	12M	YTD	3YR	5YR
Value	4.81	53.76	25.62	-11.05	32.44	-11.73	-9.26
Growth	4.62	7.02	9.79	-11.43	9.65	14.13	31.25
Momentum	-2.77	-24.43	-16.53	-16.76	-13.85	17.22	51.94
Quality	-3.14	-9.70	0.60	11.84	1.04	28.35	31.84
Risk	1.71	60.19	19.27	-8.09	28.56	2.73	-2.10

Source: Bank of America-Merrill Lynch European Quantitative Strategy, FactSet.

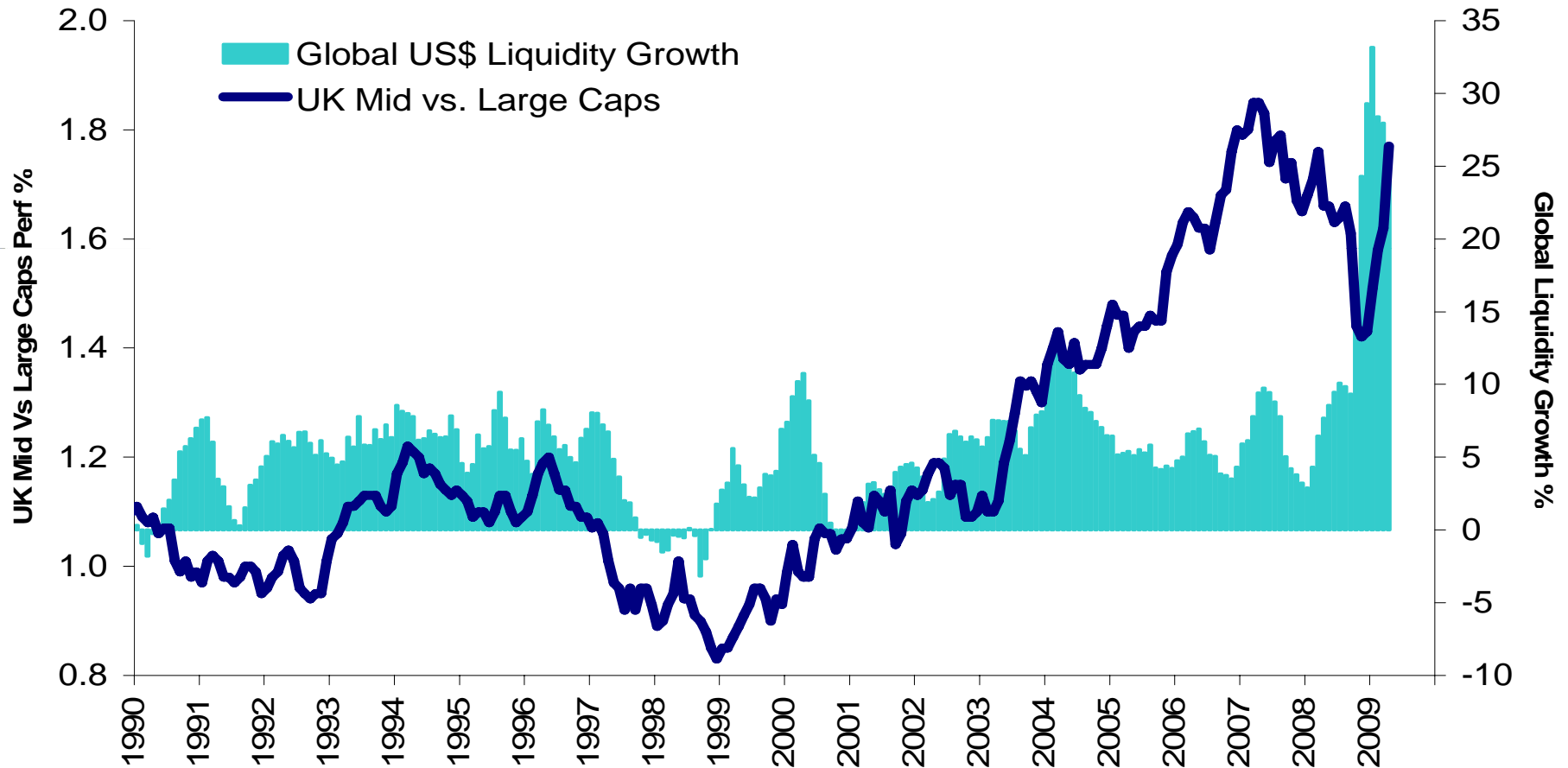
Strong conviction for Value Stocks

Global Growth vs. Value - Prospective P/E Relative



Strong conviction for Small Caps

Changes in Global Liquidity Growth & Small vs. Large Cap Performance



Seeking Pricing Power

BAS-ML Profit Mix Screen – Quadrant Analysis based EPS & Sales Revisions

<p>MARKET SHARE GRABBERS</p> <p>(Sales revisions rising but falling EPS revision ratio)</p>	<p>STARS</p> <p>(Sales revisions rising and rising EPS revision ratio)</p>
<p>DOGS</p> <p>(Sales revisions falling and falling EPS revision ratio)</p>	<p>COST CUTTERS</p> <p>(Sales revisions falling and rising EPS revision ratio)</p>

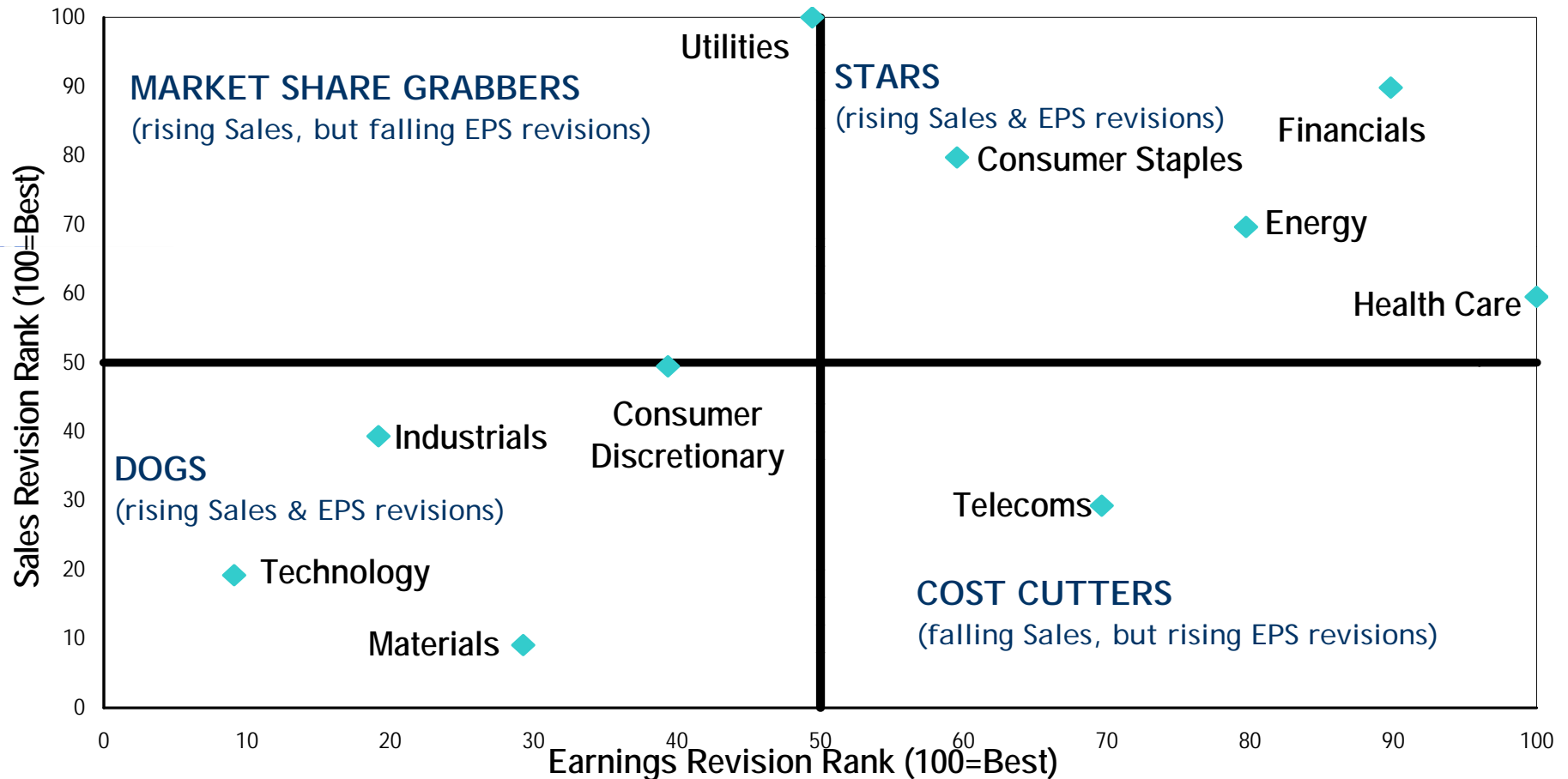
<<< Neg. Sales Revs. Pos. Sales Revs. >>>

<<< Negative EPS Revision Rank

Positive EPS Revision Rank >>>

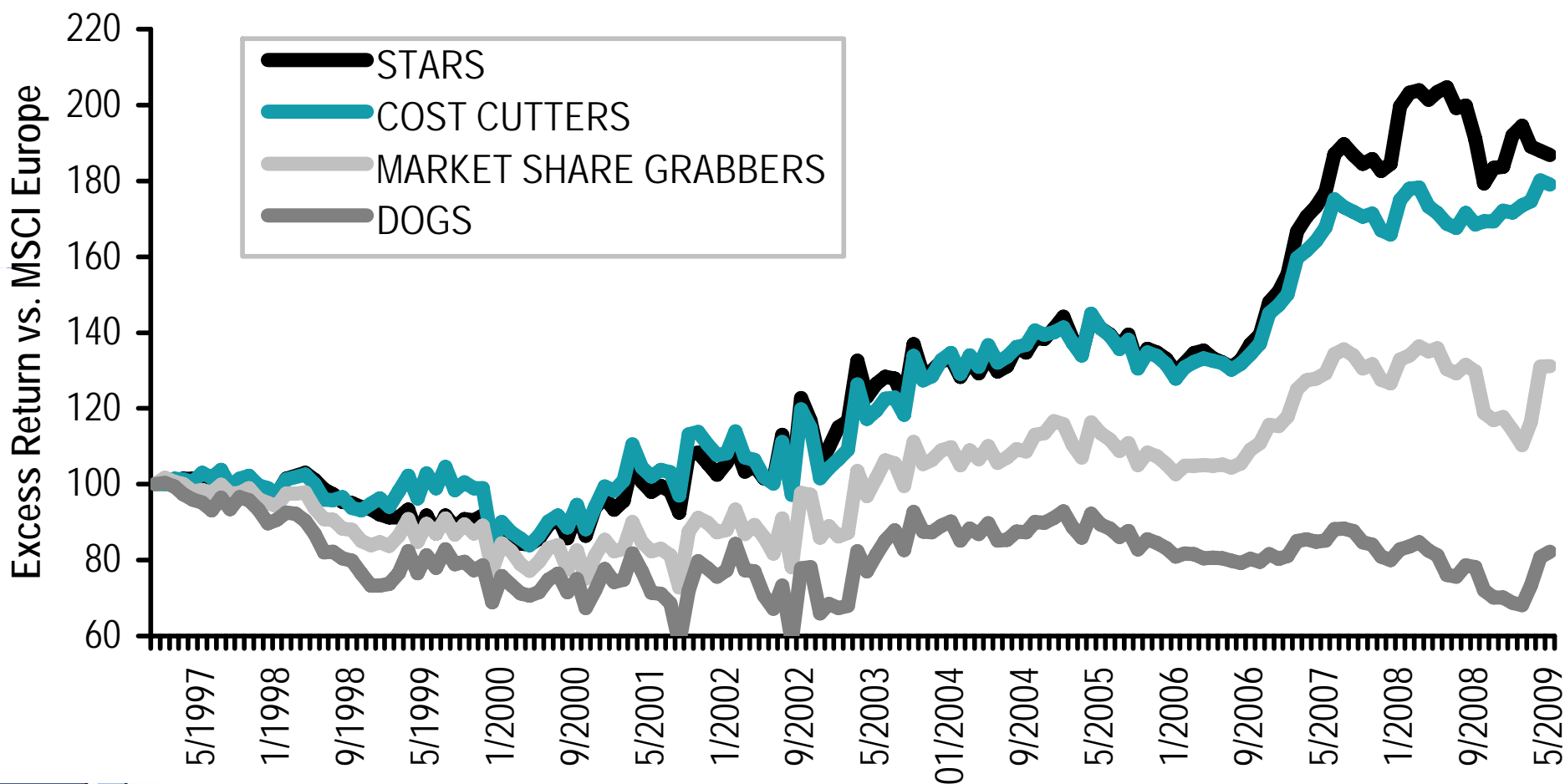
STARS vs. DOGS

BAS-ML Profit Mix Screen – Quadrant Analysis based EPS & Sales Revisions



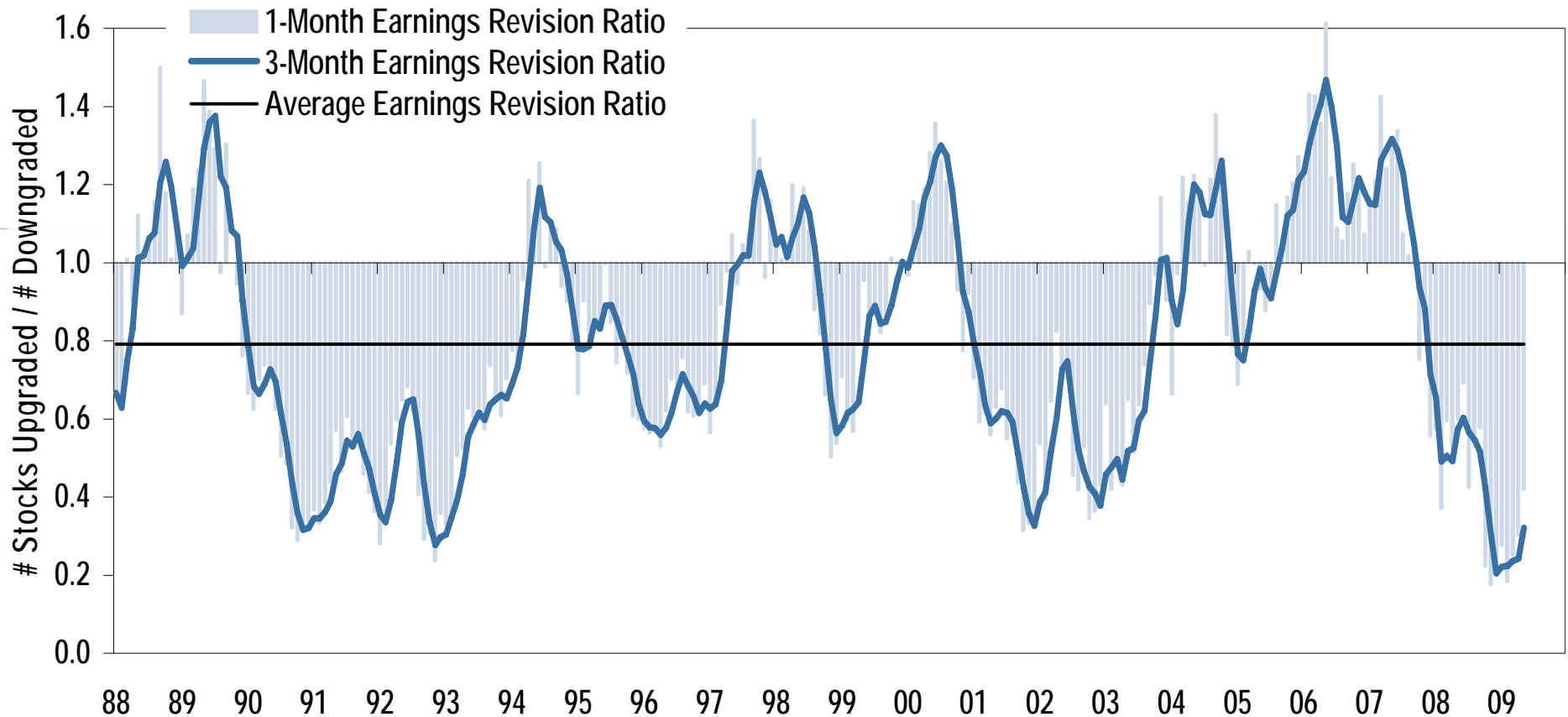
STARS vs. DOGS

BAS-ML Profit Mix Screen – Quadrant Analysis based EPS & Sales Revisions



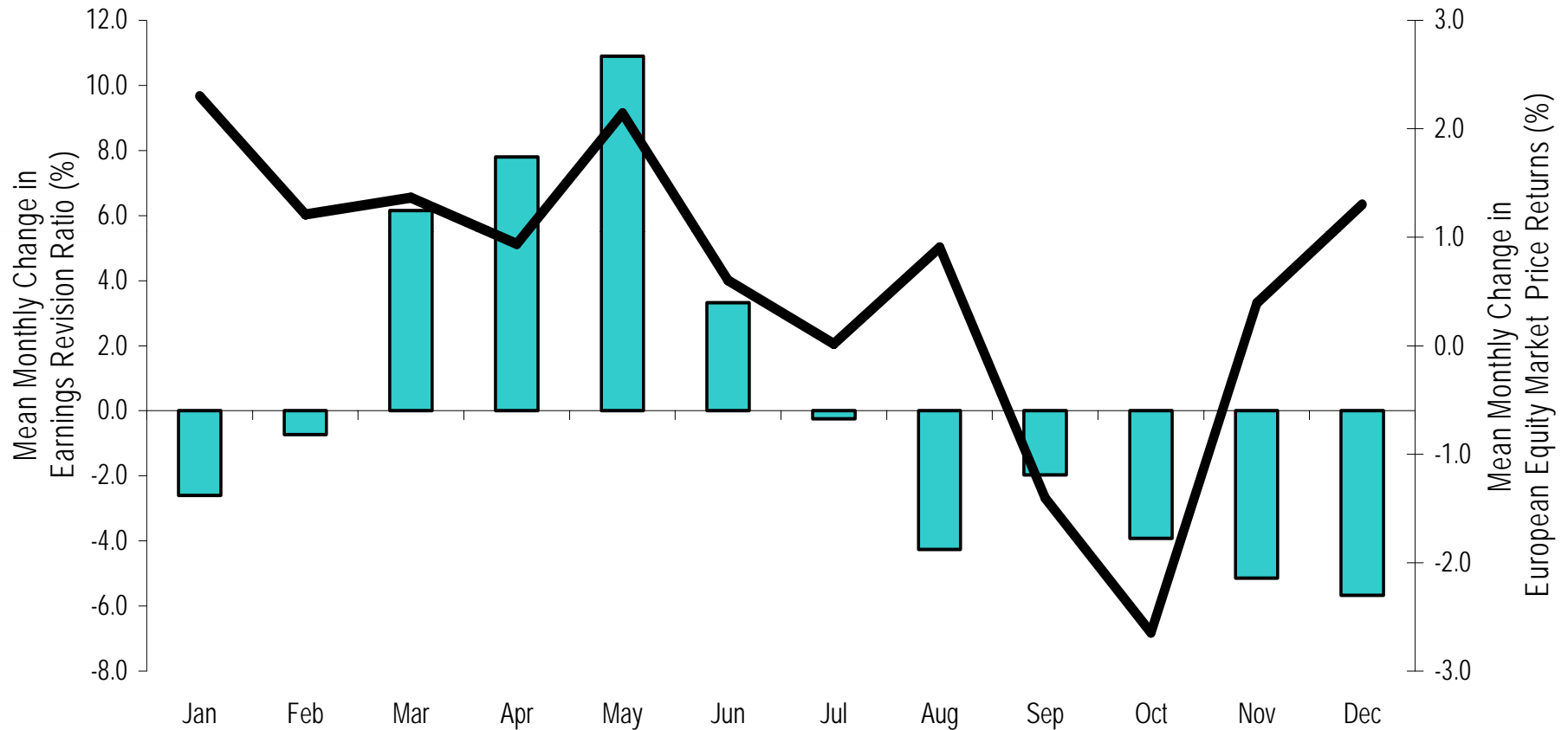
Europe's EPS Revision Ratio

Pan European Earnings Revision Ratio – 1 month & 3 month ratios



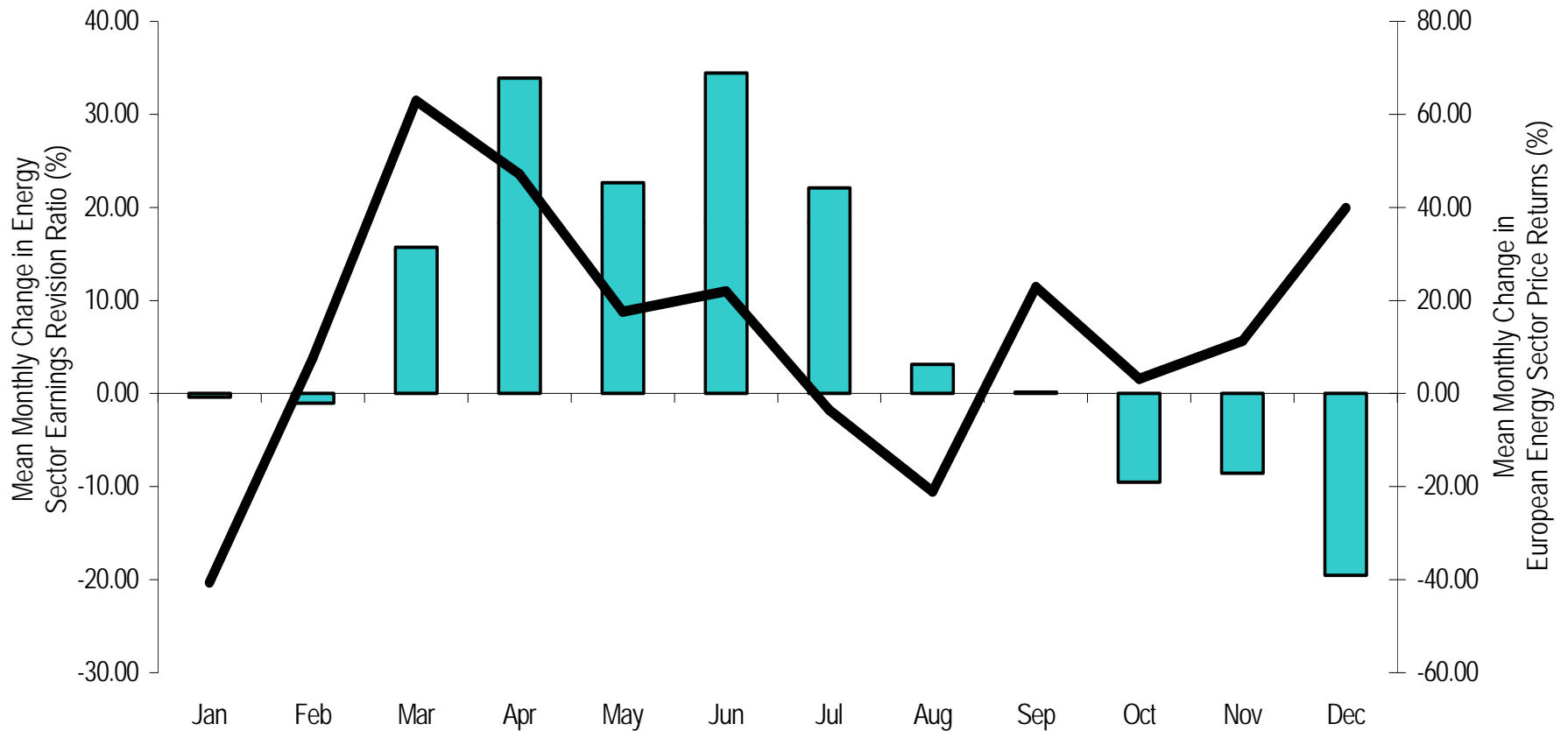
Sell in May, Buy in October

Average Seasonal Changes in Pan European 3M EPS Revisions & Price Perform



Q2 is seasonally the best for Energy

Average Seasonal Changes in Energy sector, 3Mth EPS Revisions & Price Perform



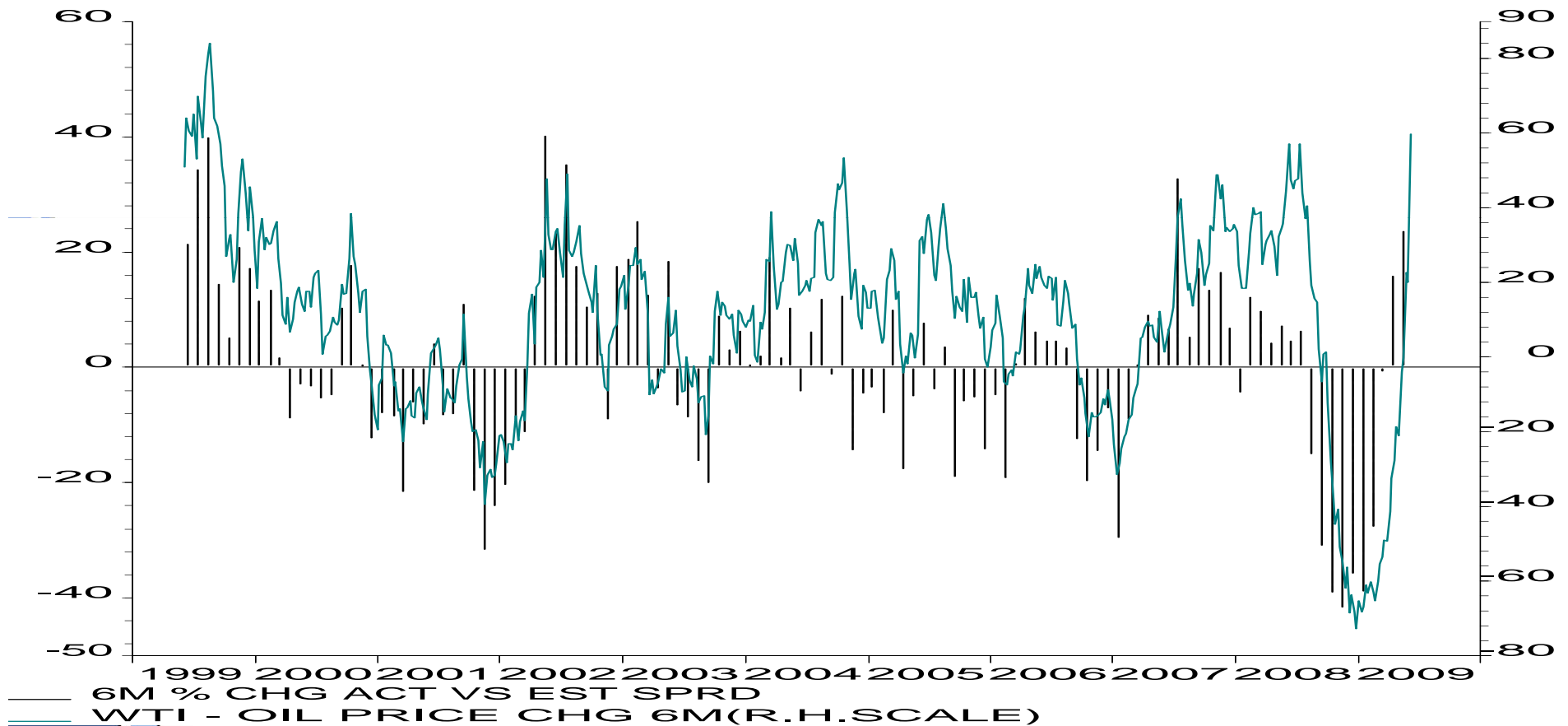
The outlook for WTI & Energy Stocks

Crude Oil Price – WTI & 12mth Forecast of WTI from Consensus Economics



Where is the Oil Price heading?

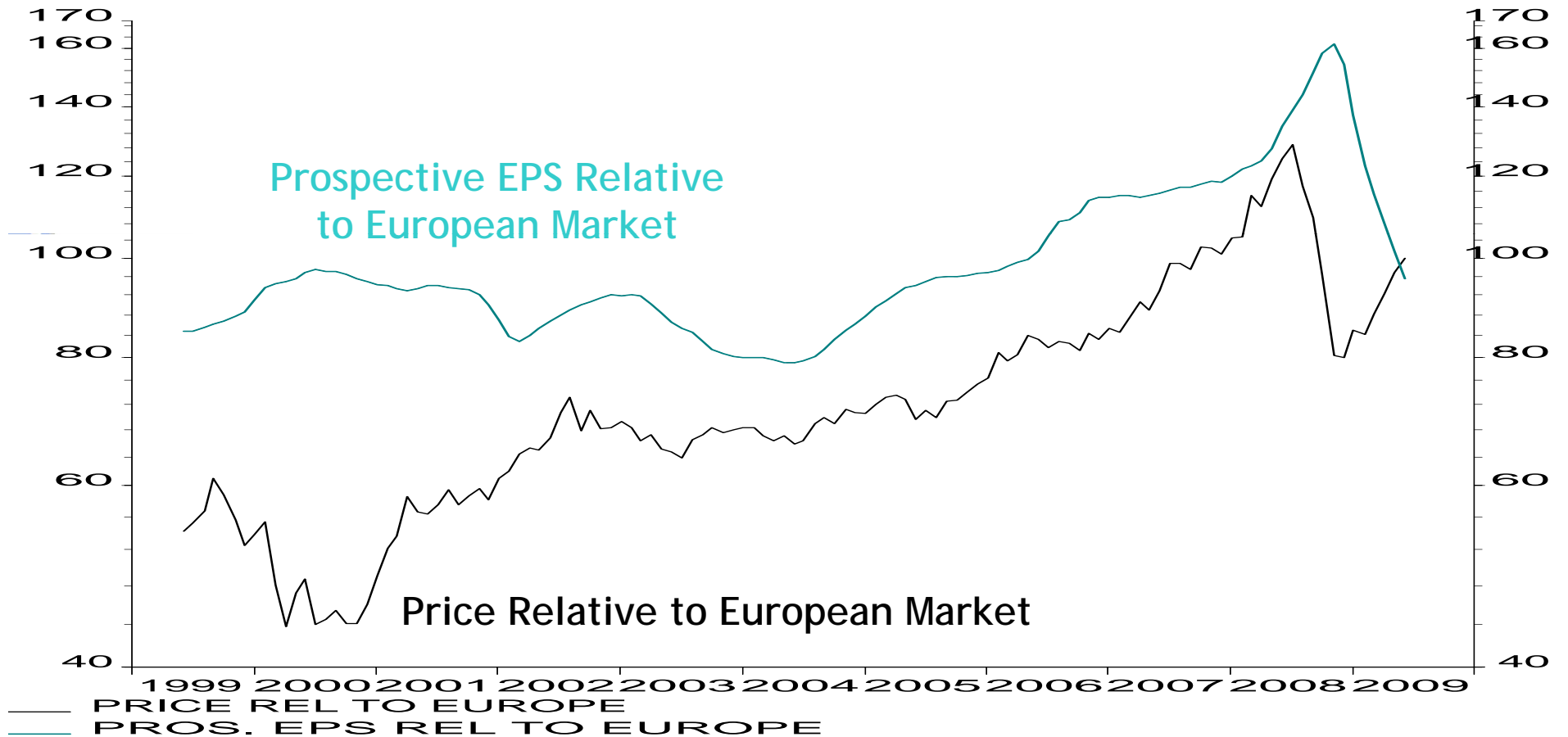
Spread between Actual & Forecast WTI Oil Price Index & WTI Price Crude Oil Prices



European Materials

**Most expensive sector
P/E relative in 10 years!**

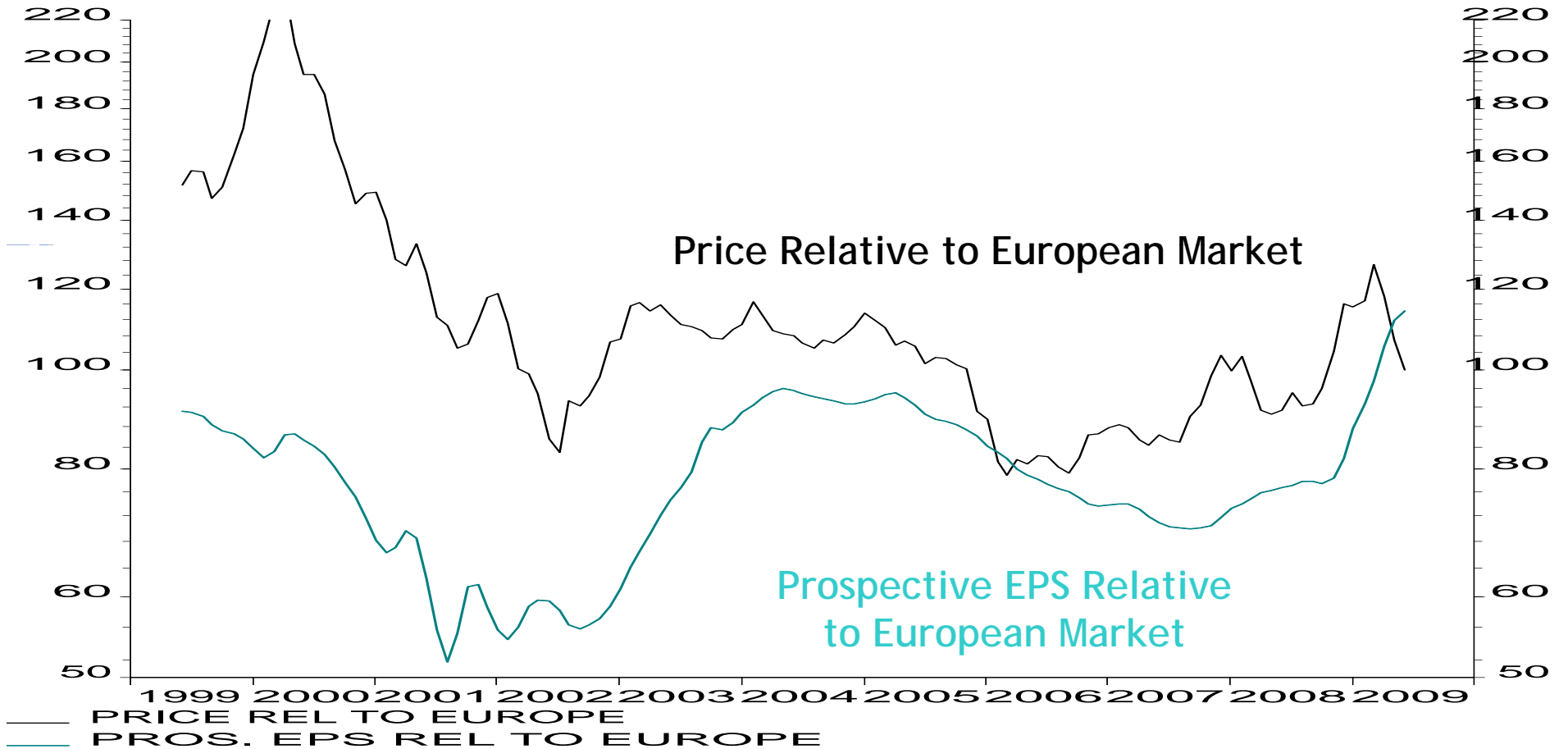
Materials vs. Europe – Price & Prospective EPS Relative



European Telecoms

Telecom vs. Europe – Price & Prospective EPS Relative

Least expensive sector
P/E relative in 10 years!



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Investment Strategy Themes

- Investors are concerned about the upside risk to inflation. Bond yields are rising and yield curves are steep. But it is 'bear-steepening' rather than 'bull-steepening'.
- Profits growth likely to remain anaemic. 1) USD falling, Euro/ GBP rising, 2) Input costs rising, 3) Good news on de-stocking unlikely to continue in H2-09, 4) Absence of top-line sales growth.
- Investors finally capitulating and sentiment no longer depressed.
- Many cyclical indicators like Energy prices and EPS revisions are highly seasonal.
- Equities expected to outperform bonds near-term, Non-US Equities to rise more slowly than before and eventually under-perform US stocks as high risk appetite wanes.
- Small Caps to continue outperforming Large Caps, Value to outperform Growth and High Quality to outperform Low Quality stocks.

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