Deutsche Bank

Deutsche Bank Research: The House View

October 25, 2012

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The House View – October 25, 2012

- The global slowdown appears to be bottoming out and we expect a modest recovery in 2013, with an acceleration of growth in the second half of the year. Although deleveraging by households and damaged banking systems continues to hold back many developed economies, the outlook for the Eurozone has improved following the announcement of the ECB's framework to intervene in peripheral bond markets if necessary. Although the bloc has still to turn around its flagging economy, more progress has been made in its adjustment process than is commonly realised. We also think fears over the slowdown in China are overdone, with recent data suggesting a recovery is taking hold

- Equity markets have stalled following the central bank driven summer rally. This pause is down to both short-term profit taking ahead of the US election as well as concern over Q3 earnings season in the US, which is shaping up to be the worst since the recession. In our view, the weakness will be short lived and, unless global GDP unexpectedly weakens, earnings should pick up

- Most asset classes have delivered strong returns in 2012 as central banks have reduced tail risks, and valuations are less attractive than at the start of the year. However, the relatively benign macro environment remains favourable for stock picking and a post-US election bounce could support US markets through the end of the year. In the Eurozone, assets continue to incorporate a significant sovereign-related risk premium thus remain attractive

The views in this publication are informed by Deutsche Bank's Global Strategy Group, which advises management and clients on broad market risks and global economic and financial developments. The views and forecasts of the group, which consists of senior research staff, may occasionally differ from those disseminated by their research colleagues

Editors: Raj Hindocha, Marcos Arana, Erin Urquhart

We expect the global slowdown to bottom and see a modest recovery with growth accelerating only from H2 2013

Economic Outlook

- **Global growth of 2.9% in 2012, 3.2% in 2013, 3.8% in 2014**
- **US growth moderate, at 2.1% in 2012 and 2.0% in 2013; 2014 at 3.1%**. **Pick-up expected from H2 2013**, as fiscal uncertainty dissipates to support growth
- **Euro zone growth of -0.5% in 2012, 0.0% in 2013, 1.0% in 2014**. Growth to bottom-out in Q4, pick-up in H2 2013
- **EM growth at 4.8% in 2012, 5.5% in 2013 and 5.8% in 2014**, no hard landing in China

Central Bank Watch

- **US: Fed policy ultra loose.** Expect QE3 extension into 2013. Fed stands ready to ease more if required
- **ECB:** Expect **refi-rate cut by end-Q1**; deposit rate cut only if material deterioration
- **BoJ:** 50% chance of a JPY10tn QE increase
- **BoE: no further easing expected in Nov,** but risks of further QE / rate cut remain
- **PBoC:** 1 more RRR[1] in 2012 cut **but no major easing**
- **EM:** improved outlook following Fed / ECB actions and rising inflation have **reduce need / scope for more easing**

Key Themes

- **ECB and Fed have substantially reduced tail risks** and provided a liquidity 'safety net'
- **Euro crisis**: ECB bought time for periphery. More flexible approach to austerity a positive. Spain to ask for aid, Greece to get more time. Volatility to remain
- **US**: fiscal cliff to be avoided but uncertainty to remain until deficit reduction plans are agreed
- **China**: growth to rebound in Q4, return to potential in H2 2013

Key risks to our view

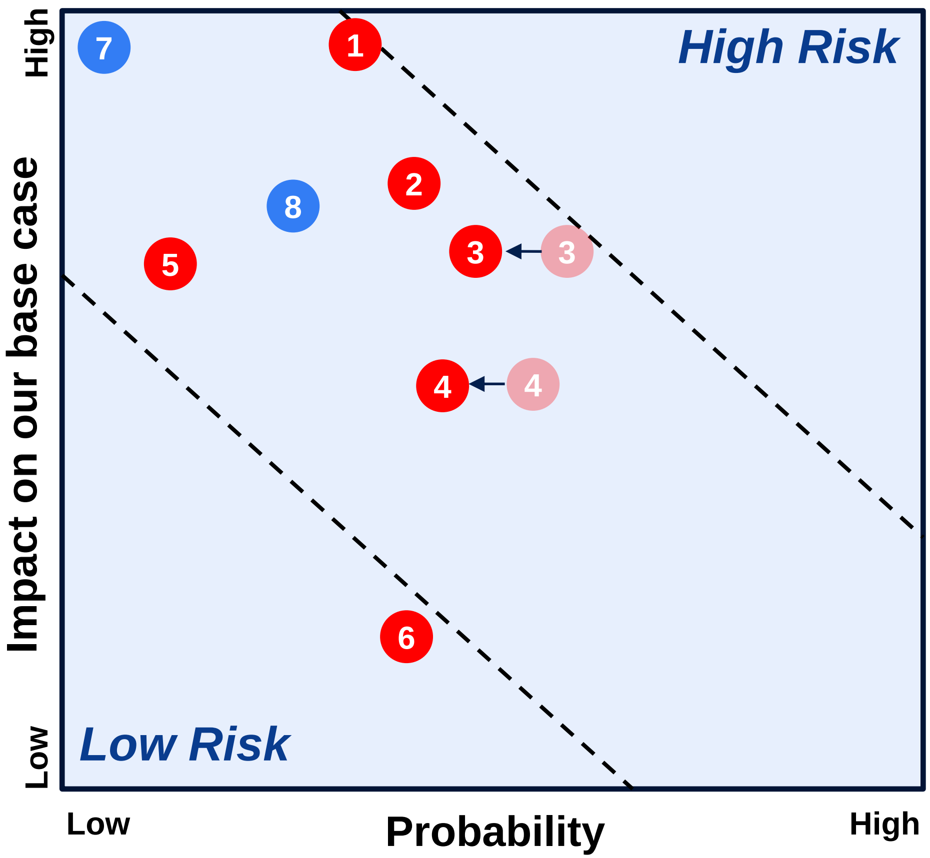
- M **Material worsening of European sovereign crisis**
- M **Lack of agreement to reduce US Fiscal cliff**
- M **Significant deterioration in Chinese data**
- M **Inflation / growth risk from higher commodity prices**
- L **Romney victory that drives a less accommodative Fed**

1: Required Reserves Ratio that major banks must hold (instead of lend out)

Note: H / M / L indicates estimated level and impact of risk (High, Medium, Low)

Risks to our view: With tail risk in Europe reduced, the key risks over the coming months are from economic data

The House View - Risk Matrix



* Moves represent change in risk outlook over previous month

Downside risks

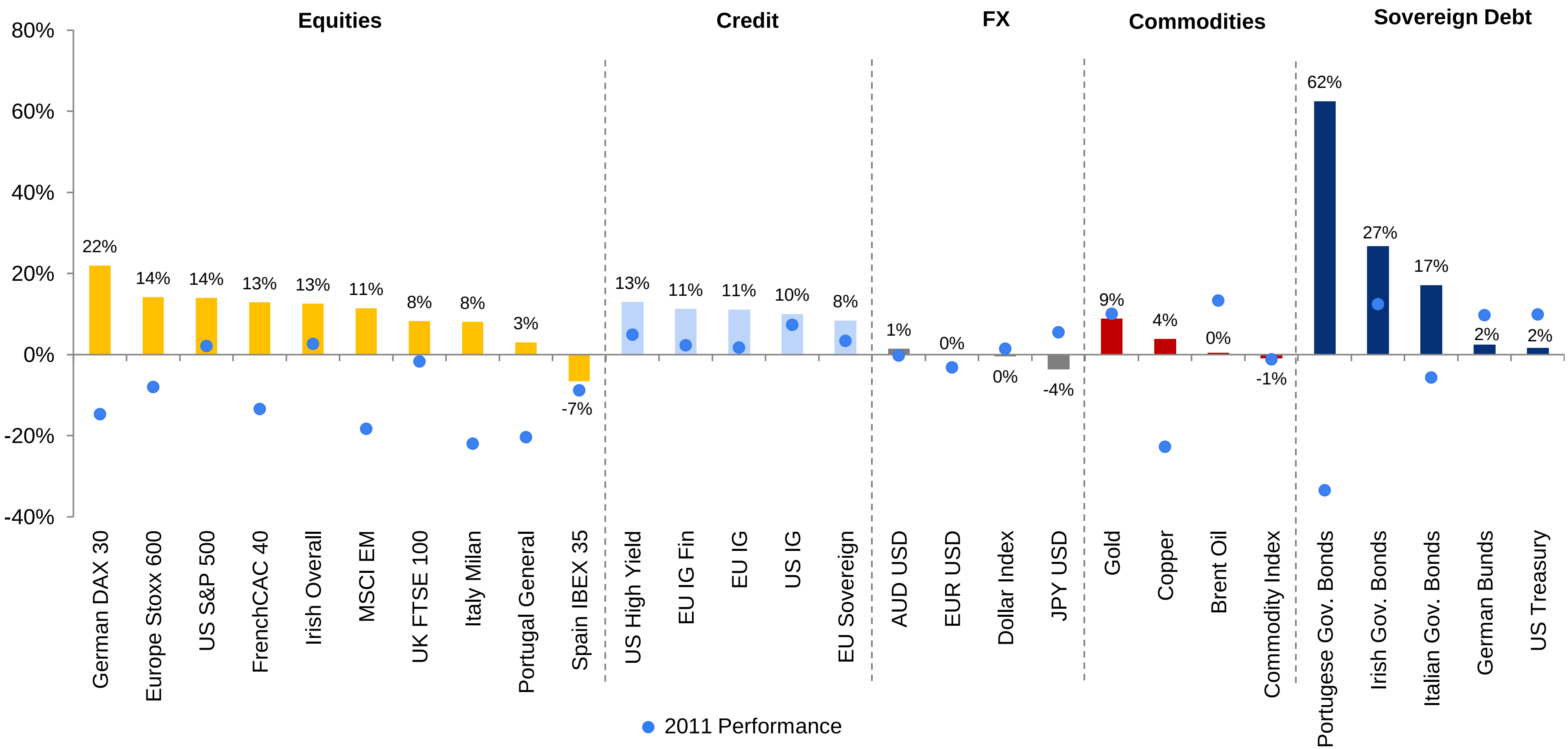
1. **Material worsening of the European sovereign crisis**, e.g., country exit, material weakening of data, concern over OMT
2. **Lack of agreement to reduce US fiscal cliff** significantly weakens US growth
3. **Significant deterioration in Chinese data** as economy struggles to rebalance and suffers sharp slowdown
4. **Inflation / growth risk from higher commodity prices**
5. **Disorderly sell-off in core bonds (US, UK, Germany)** due to ratings downgrade or concern over long-term debt sustainability
6. **Romney victory that drives a less accommodative Fed.** Romney more likely to favour a more hawkish Fed chairman

Upside risks

7. **Rapid resolution to the Euro crisis**, e.g., agreement over burden sharing, clear and convincing roadmap for euro zone, unexpected upturn in growth
8. **Global growth surprise** from credit impulse uptick post aggressive bank deleveraging in Europe/US

Most asset classes have delivered strong returns in 2012, far outpacing their performance in 2011

2011 and 2012 YTD performance (Total Returns*) across asset classes



*Total return accounts for both income and capital appreciation. Income includes interest paid by fixed-income investments, distributions or dividends. Capital appreciation represents the change in the market price of an asset. Price updated as of 24 Oct 2012, close.
Source: Bloomberg Finance LP, Deutsche Bank Research

We see signs of global growth bottoming-out, confirming our view of a modest growth pick-up in 2013

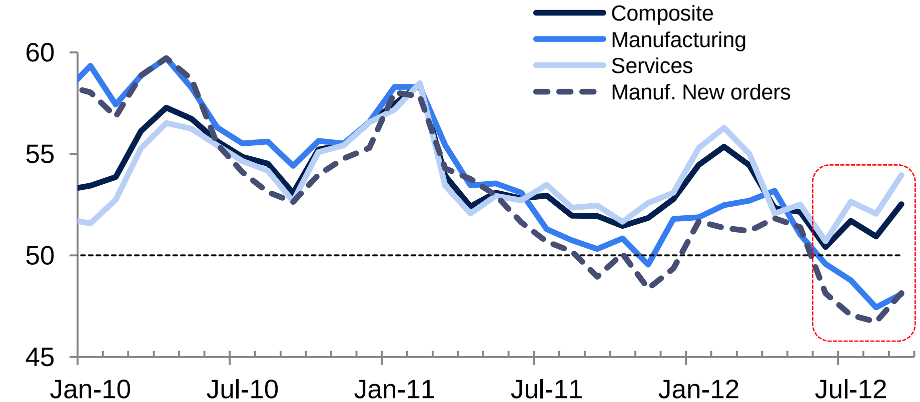
- Several factors suggest global growth will bottom-out in H2 2012

- **Global PMIs have broken their downtrend**
  - Composite PMI recovering since June bottom
  - Manufacturing remains weak, but downtrend interrupted and forward-looking new orders point to an upturn

- **Main regions**
  - Small rebound in China PMIs in September
  - Latest US macro data surprising to the upside
  - Markets are pricing in such a bleak scenario in Europe that a positive growth surprise is likely

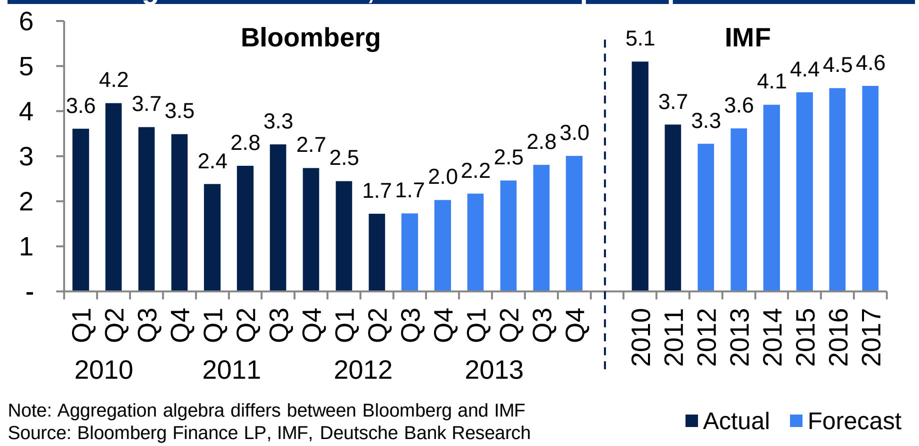
- **Third party growth forecasts also point to a bottoming-out of growth in H2 2012**

Global PMI bottomed in June; manufacturing still low, but downtrend interrupted in September, new orders point to upturn



Source: Haver analytics, Deutsche Bank Research

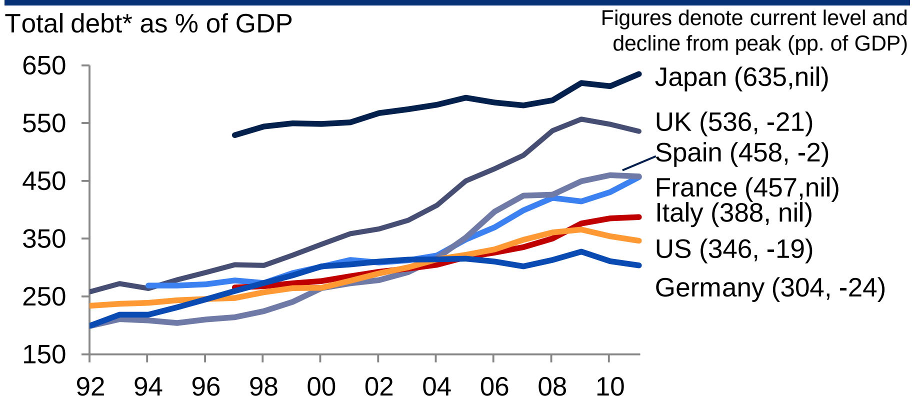
Global GDP growth (% yoy): 3rd party forecasts point to growth bottoming-out in H2 2012, and a modest pick-up in 2013



Note: Aggregation algebra differs between Bloomberg and IMF
Source: Bloomberg Finance LP, IMF, Deutsche Bank Research

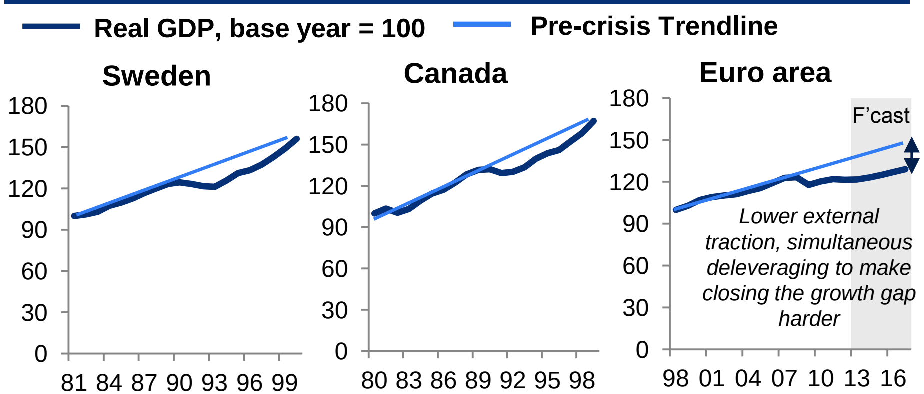
Nevertheless, high levels of debt and the need to work it off in developed markets will mean growth will remain modest

Total leverage has gone up dramatically since the 1990s



*Includes household, financial sector, corporate and government debt
Source: Haver Analytics, Deutsche Bank Research

Global deleveraging is set to make the recovery harder this time than for Sweden or Canada in the 1990s



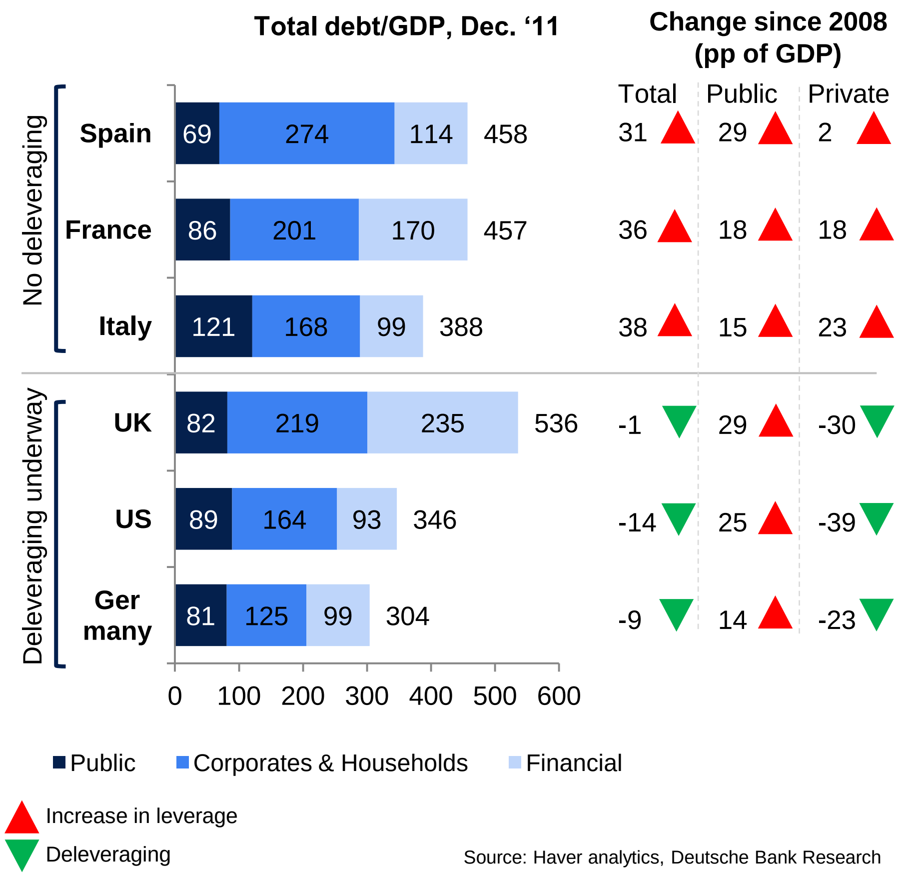
Source: IMF, Deutsche Bank Research
(*) Rogoff & Reinhart "This Time is Different" (Princeton University Press, 2009)

- **Leverage has grown substantially in the last 20 years and remains high across DMs**
  - Measured as % of GDP, includes public and private (households, financials, corporates) debt
  - Debt has gone up by 100-250pp since 1990s
- **Deleveraging is the process of reducing debt**
  - Reducing debt to GDP requires some combination of growth, inflation and default
  - Deleveraging can proceed forcefully or in a well-paced, sequenced way – across debtor sectors within one country, but also across countries
- **Deleveraging is negative for growth in the short-term – even more so after a deep financial crisis***
  - Successful deleveraging (e.g., Sweden / Canada in 90's) requires aggressive up-front loss recognition, bank recapitalisation and accommodative fiscal and monetary policy
  - The US and the UK are faring better on this metric than Europe
  - Sweden and Canada also benefited from a global economy which is less likely today given the global nature of the crisis

LT Asset Return Study: A Journey into the Unknown 04 Sep 12

In the US, where the government held back on debt reduction, private sector deleveraging has progressed faster than in the Eurozone

US government is running large deficits to support private deleveraging; in most of Europe, deleveraging has yet to begin

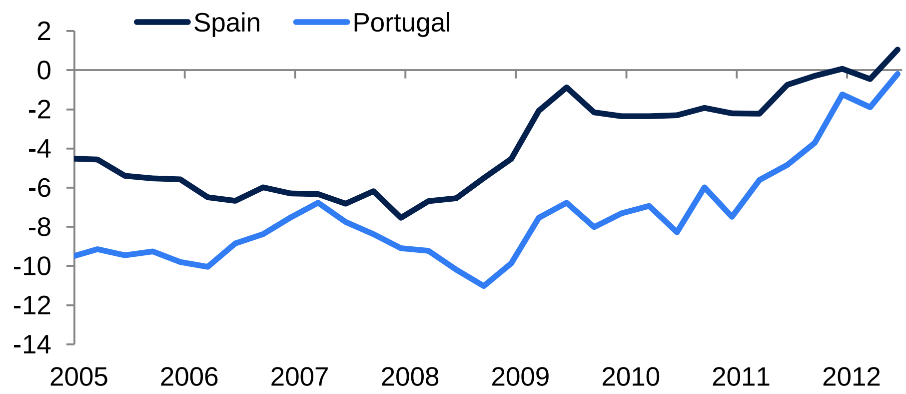


Source: Haver analytics, Deutsche Bank Research

- **Deleveraging faster in the US than in Europe**
  - Total debt / GDP has fallen in the US by 20pp since its 2009 peak, whereas in Europe most countries (other than Germany) have seen debt rise
  - Public debt has risen in all countries during this time
- **Not all sectors can delever at the same time** and sequencing is important
  - Ideally the public sector would hold off deleveraging while the private sector does
  - Public leverage can later fall as the private sector reinvests, spurring growth
- In the **US the government has deliberately held back on debt reduction** and run public deficits larger than in Europe – **allowing the private sector to delever**
- **Market pressure has made this impossible** in peripheral Europe, where public (via austerity) and private (e.g., banks) sectors are deleveraging simultaneously – **depressing short-term growth**

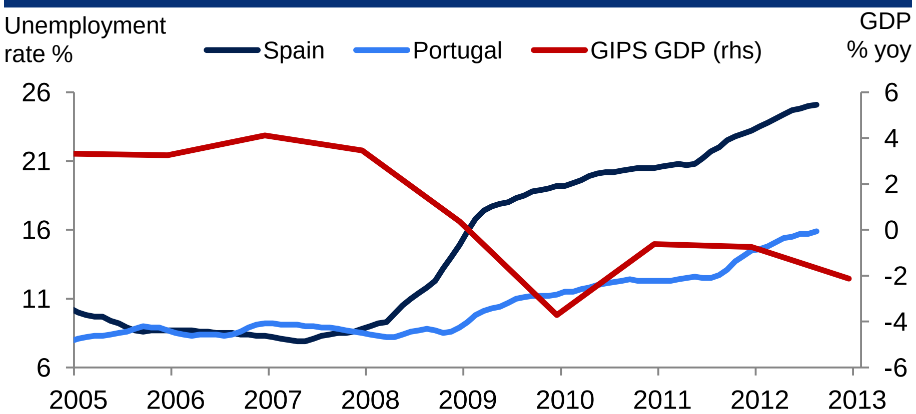
Although austerity is still the plan in Europe, the temporary flexibility to lower the impact of public deleveraging on growth is welcome

Trade balance (% of GDP): Spain and Portugal are moving into trade surplus



Source: Haver Analytics, Deutsche Bank Research

Unemployment and growth continue to worsen in periphery



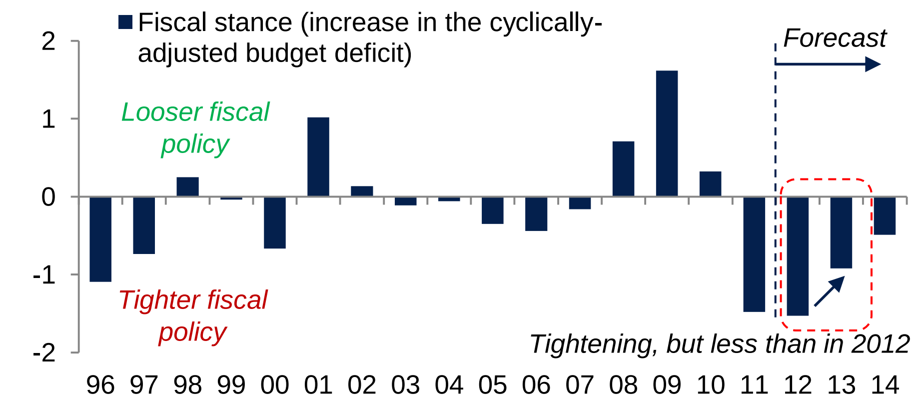
Source: Eurostat, IMF, Deutsche Bank Research

- **Peripheral competitiveness is improving**
  - Trade balances have improved, driven by both higher exports and lower imports
  - Unit labour costs are starting to adjust
  - Yields on public debt are lower
- However, in the periphery **growth remains low, unemployment high**, and **public support for more austerity is fading**
- **To prevent austerity from crushing nascent growth**, authorities are shifting their stance
  - Slower pace of adjustment in the periphery
  - More fiscal stimulus in the core
- **Recent decisions have indicated the new stance**
  - IMF's Lagarde has advocated less "front-loading" and a "bit more time" for peripherals
  - EU agreed to larger 2012 deficits in Portugal, Spain
  - Chancellor Merkel has indicated a willingness to cut taxes in Germany to stimulate the Eurozone
- **Austerity and structural reform remain the game plan** to restore competitiveness, increase long-term growth potential and ensure debt sustainability

In Europe, 2012 may have been the peak of austerity, with growth set to resume in H2 2013

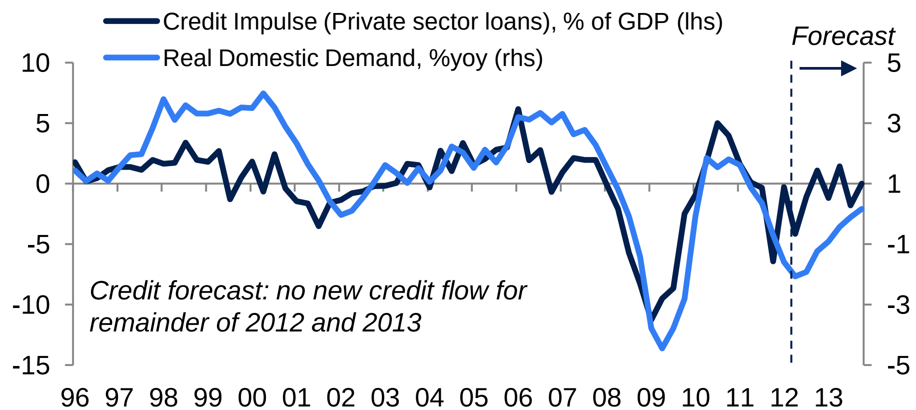
- **Improving credit impulse and fiscal stance will be supportive of demand growth**
  - GDP growth to resume in H2 2013
- **2012 may be the peak of austerity, which should be positive for 2013 growth**
  - Extraordinary fiscal tightening in the Eurozone – -1.5% of GDP in each of 2011 and 2012, something never seen in the past 2 decades
  - Tightening will continue, but at a slower rate of -0.9% and -0.5% in 2013 and 2014 respectively
  - This will have a positive effect on 2013 growth
- **Euro area credit impulse** may also stabilise**
  - Some signs that banks are deleveraging at a slower pace
  - Credit growth could stabilise at -1% in the coming quarters, with credit impulse turning positive in Q4 2012
  - This would lead domestic demand to stop contracting in Q1 2013 – a positive for growth

Eurozone fiscal stance* (% of GDP): 2012 may be the peak of austerity; more tightening expected in 2013, but at a lower pace



Source: European Commission, Deutsche Bank Research

Eurozone credit impulse points to upside for the recovery**



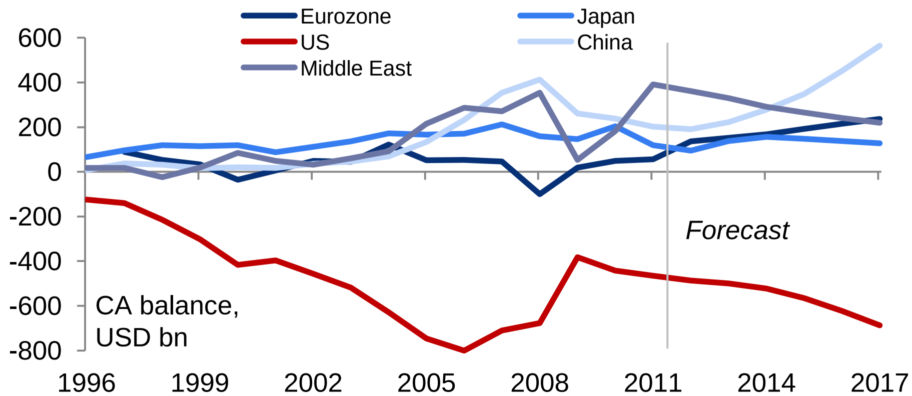
Source: Eurostat, Haver analytics Deutsche Bank Research

European Equity Strategy - Now's the time 11 Oct 12
Focus Europe - Passing peak austerity 10 Oct 12

Notes: (*) The fiscal stance captures the discretionary tightening / easing of fiscal policy
(**) DB's non-consensus view is that what is important for domestic demand growth is not credit growth, but the change in credit growth. A slowdown in the pace of deleveraging boosts spending growth, even though credit growth is still negative. We call this change in credit growth the credit impulse

The US is the ultimate wildcard. A forced deleveraging event would prompt another global recession

The US current account (CA) deficit mirrors CA surpluses elsewhere; Eurozone turning increasingly positive



Source: IMF, Deutsche Bank Research

Economy	Key drivers of CA surplus
Gulf states	Oil, oil products exports
China	Weak currency, low domestic demand, strength in manufacturing, export-oriented industrial policy
Germany	Weak currency, strength in manufacturing, export-oriented industrial policy
Japan	Positive income balance, i.e., dividends and gains from Japan corporates in foreign investments

Note: Current Account = Trade balance (exports minus imports) plus net returns from overseas investments / assets overseas

- **The US is now driving global demand**
  - Zero sum game: all countries cannot run a current account surplus at the same time
  - One country's CA surplus is another's CA deficit
  - The US deficit is the biggest driver of surpluses in the Gulf, Asia and, to a lesser extent, Europe
- **A sharp public sector deleveraging in the US** (fiscal contraction) **would lead to a US recession, and in turn to a global recession**
  - A sharp fiscal tightening (spend reduction or tax rises) in the US would strongly depress domestic demand and tip the country in recession
  - Falling imports would hurt US' trading partners
  - Growth shock in Japan, China, Germany would be greater than in the US – China could see a hard landing
- **A permanent solution to global imbalances requires a combination of:**
  - More saving in the US and CA deficit countries
  - More consumption in CA surplus countries

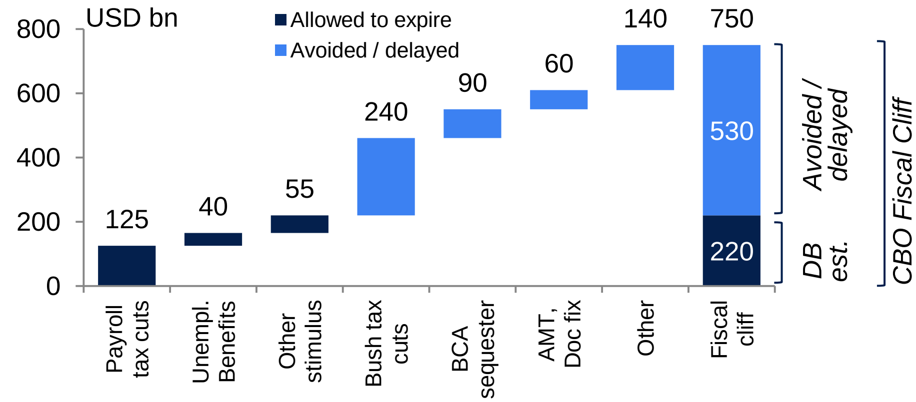
FX Daily - Remember Global Imbalances? 12 Oct 12

We expect the fiscal cliff, one of the key uncertainties looming over the US economy, to be avoided – but at the risk of a credit downgrade

- **The fiscal cliff a key drag facing the US economy**
  - Refers to expiration of tax breaks / spending increases at the end of 2012
  - If nothing is done, the fiscal adjustment in 2013 would be USD 750bn or 5% of GDP
- **Fiscal uncertainty is causing firms to delay hiring and spending plans – hurting growth**
  - 33% of manufacturers are deferring hiring*
  - GE, Siemens, Honeywell, UPS, Eaton have all cited the fiscal uncertainty as a threat to earnings
  - Military contractors could lay-off workers en masse if sequester** kicks-in
- **Expect deal after the election** to reduce the cliff
- **QE3 can offset some of the impact of the cliff**, but has also reduced the urgency to strike a deal
- **Several risks associated with the fiscal cliff**
  - Significant recession risk if cliff not reduced
  - Credit downgrade – from political gridlock on fiscal policy, or avoidance of sequester

Notes: (*) Survey by Manufacturers Alliance for Productivity and Innovation
(**) BCA sequester: automatic spending cuts put in place during 2011 "debt ceiling" negotiations, mostly consisting of cuts in military spending (50%), Medicare providers and scientific research

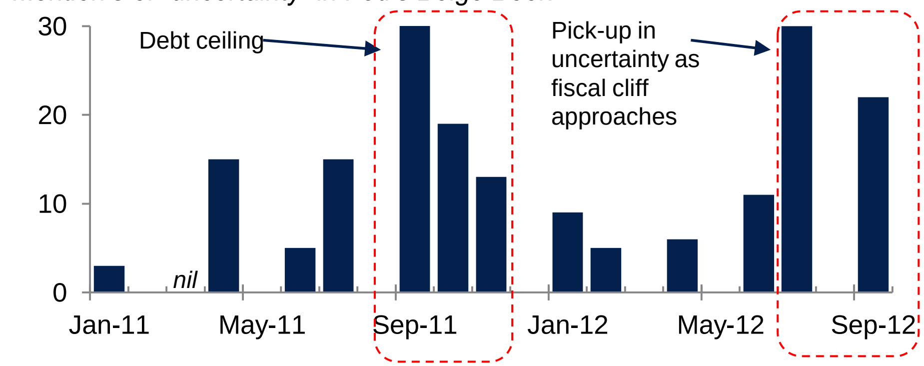
US Fiscal Cliff: we expect the fiscal cliff to be substantially reduced to 1.5% of GDP (USD 220bn) from 5% of GDP



Source: US Congressional Budget Office, Deutsche Bank Research

The Fed's Beige Book* points to a higher level of uncertainty than usual

Mention's of "uncertainty" in Fed's Beige Book



* Beige Book is the common name for the Fed's report on economic conditions, published 8 times a year.
Source: Federal Reserve, Deutsche Bank Research

US growth should pick-up from H2 2013, as fiscal uncertainty gets resolved under the new presidency

- **US economy continues to expand at a slow pace**
  - Labour market remains weak
  - Manufacturing sector disappointing
  - Business spending (hiring / investment) lagging

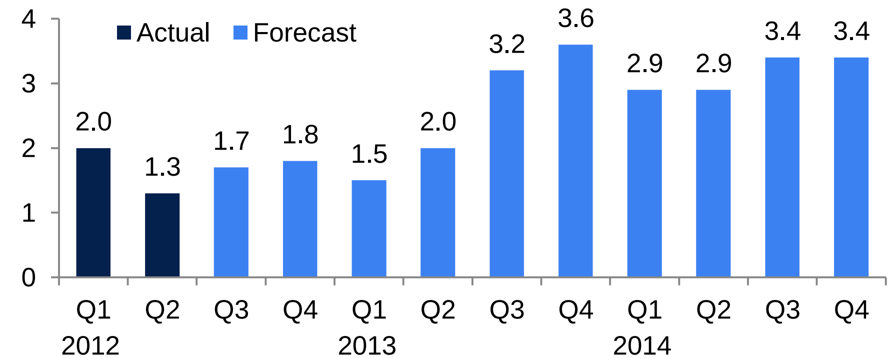
- There remain **several downside risks**
  - Domestic: fiscal cliff, risk of debt downgrade
  - External: eurozone uncertainty, slowdown in China, Middle East tensions inducing oil shock

- However, **lifting of fiscal uncertainty will support growth** via a more certain investment climate – unlocking business hiring and investment decisions

- We **remain optimistic about long-term prospects**
  - **Housing** sector stabilisation now an upside risk, even if sector recovery will remain slow
  - **Private sector deleveraging** well underway – deleveraging pace to slow down, boost spending
  - **Consumer spending** remains resilient
  - **Manufacturing revival** driven by cheap energy costs due to shale oil / gas boom

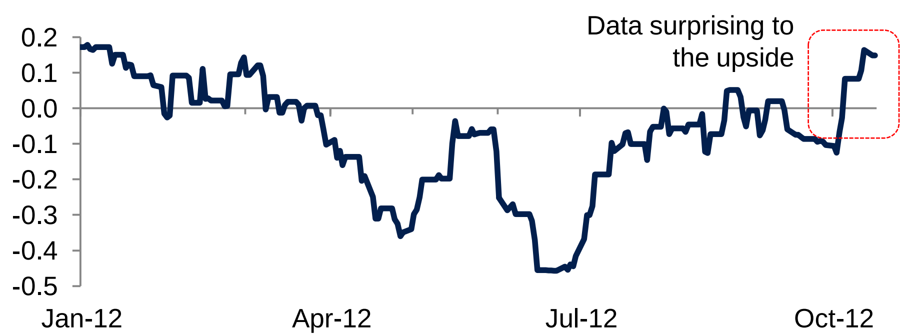
US GDP: Expect pick-up in growth from H2 2013

% growth GDP, quarter-on-quarter



Source: Haver Analytics, Deutsche Bank Research

DB Macro Pulse Indicator (MPI): downward trend has reverted, the index now signals US data is surprising to the upside

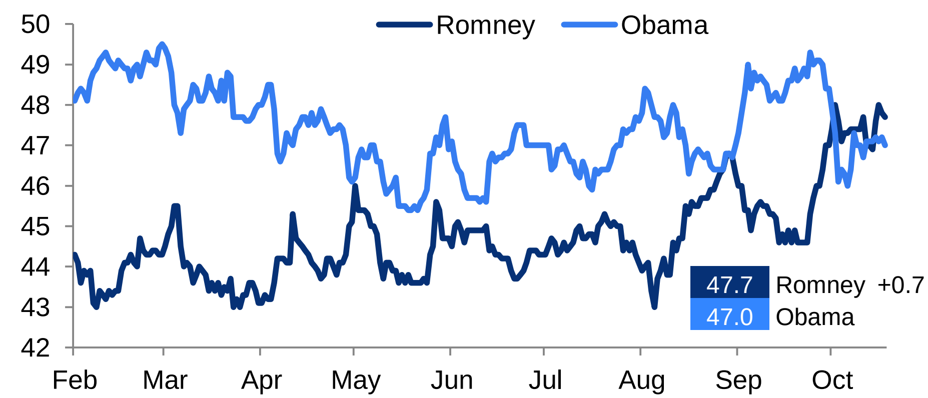


MPI measures data surprises; positive / negative readings indicate data has surprised to the up/ downside
Source: Deutsche Bank Research

The race for the White House remains close. Romney marginally leads the popular vote, but the electoral system would see an Obama victory

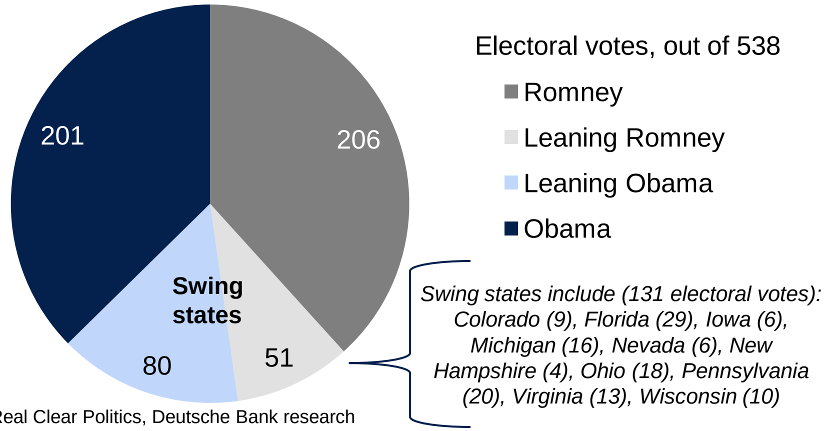
- **Key dates**
  - Election date: 6 November
  - Inauguration date: 20 January 2013
- **US presidents are elected indirectly via electors**
  - Public votes for a candidate / party in each of the 50 states
  - In all but 2 states, the **winning party receives all electoral votes for the state**, regardless of actual vote count / win margin (i.e. "winner takes all")
  - Total 538 electors vote in the Electoral College
- Many states consistently vote Republican or Democrat – the election will be determined by the outcome in **"swing states" i.e., states with changing majorities**
- The election is very close to call, but **according to the current polls Romney would win the popular vote and Obama would win the election**
- **Legislative elections** (House and Senate) **point to a divided government** and the risk of political gridlock

General elections poll average: Romney has a small lead in the polls for the popular vote…



Source: Real Clear Politics, Deutsche Bank research

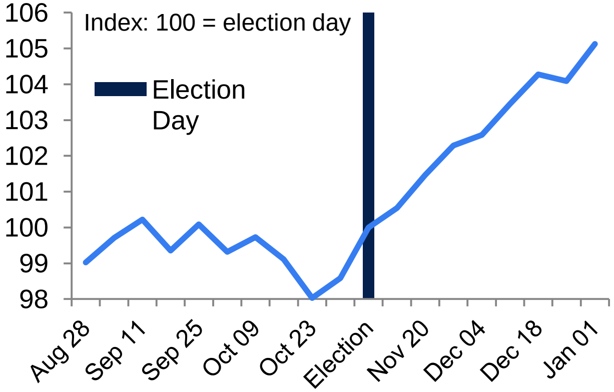
Electoral votes count: … but electoral system would give Obama a win in current polls



Source: Real Clear Politics, Deutsche Bank research

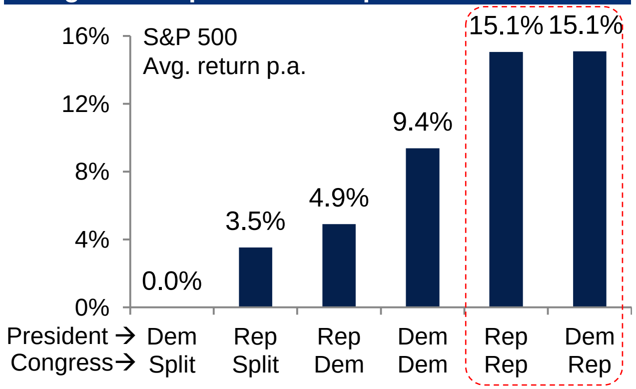
Equities have typically rallied following close elections; over the long-term economic and policy fundamentals will matter most

In close elections S&P has been flat before the election, and rallied after (5% by year-end)



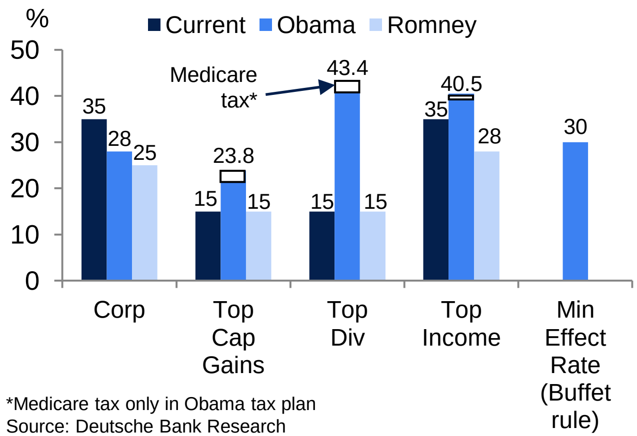
Source: Bloomberg, Deutsche Bank Research. Note: Includes 1952, 1960, 1968, 1976, 2004 elections

Democrat presidencies and Republican Congress are positive for equities



Note: S&P average annual returns for all years since 1933
Source: Bloomberg, Deutsche Bank Research

Fundamentals: Romney's tax plans are seen as more business friendly



*Medicare tax only in Obama tax plan
Source: Deutsche Bank Research

- Equities typically rally after close US elections
- **Domestic cyclical sectors** (Tech, Financials, Industrials) are **best placed to profit from any post-election** upswing
- **Romney victory would likely provide a stronger near-term boost** for equities

- **Equities have historically rallied more under Democrat presidencies and under Republican Congresses** (annual return for S&P500):
  - 10%+ under Democrat president vs. ~5% under Republican
  - 15% under Republican Congress
- Romney more likely to favour a more hawkish Fed chairman in 2014
- USD likely weaker under Obama (EUR/USD 1.35-140) than under Romney (1.30-1.35)

- **Romney win** would likely mean a **more favourable tax policy** outcome
  - Seen as more business 'friendly'
  - Lower risk of gov. split / gridlock
  - Supportive for US assets
- **Sectors winners under:**
  - **Obama:** Alternative Energy, Infrastructure, Insurers, Hospitals
  - **Romney:** Defence, Energy, Financials, Overseas Cash Rich Tech, Large Commercial Health Insurers

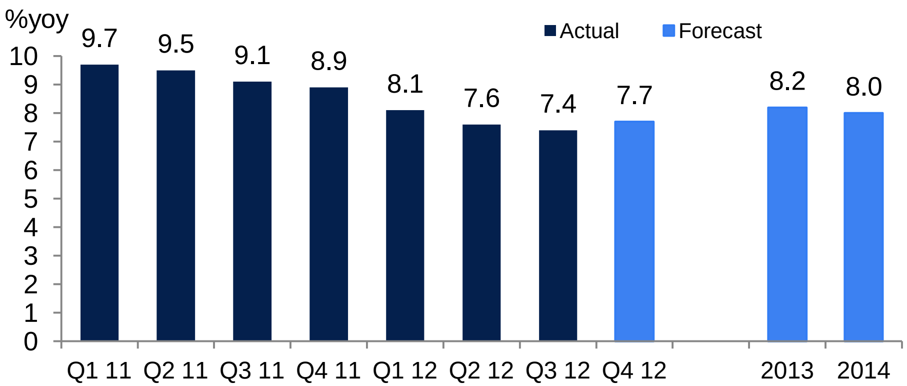
We expect progress over Spain and Greece in November. Heading into 2013, Italy and France could come into market focus

		Update
Through end-2012	**Expect aid request before year-end**	▪ Spain will ultimately request aid by year-end as market pressure builds ▪ Madrid seeking to avoid additional reform / austerity beyond what it has announced ▪ After aid request, actual intervention could take longer than market expects as agreement between European capitals, the EC, the ECB and the IMF is being built
Through end-2012	**Bailout programme to get 2Y extension**	▪ Greece continues to be off track but the coalition government has been more cooperative and stable than expected, and EU appetite for a Greek exit remains low ▪ Expect a short-term "fudge" to keep Greece going without increasing the second loan ▪ Substantially reduced risk of a Greek exit before the German elections in Q3 2013
Q1 2013 and beyond	**A key focus in Q1 2013**	▪ Italian fundamentals are more sustainable than Spain, with a primary surplus and substantial private wealth ▪ Politics the main concern; elections (Apr-2013 at the latest) a source of volatility ▪ Market reaction to politics to determine whether Italy pushed towards EU support
Q1 2013 and beyond	**At risk of market pressure**	▪ Current deficit reduction plan is skewed towards higher taxes thus negative for growth ▪ Low corporate profitability to drive further labour weakness, lower consumer spending ▪ Unrealistic growth projections to result in deficit misses, could lead to market pressure
Q1 2013 and beyond	**Fiscal union pace to slow in 2013**	▪ Expect limited further steps towards integration until after German elections in Q3 2013 given internal politics in France & Germany, as well as disagreements on direction between the two (on banking union, Eurozone budget, debt mutualisation)

Focus Europe - Agreeing to disagree 19 Oct 12

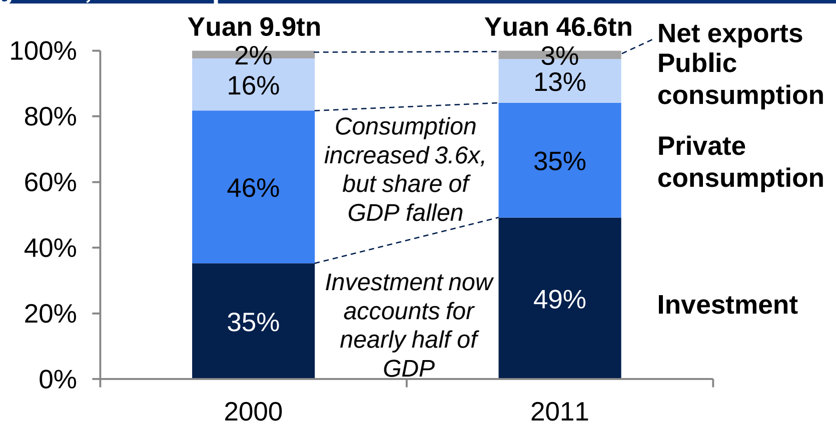
Recovery in China will come sooner than expected. Growth should return to its potential rate of ~8.5% in H2 2013

China Q3 GDP came in at 7.4% - sixth quarterly decline in yoy growth; expect modest recovery in Q4



Source: NBS, Deutsche Bank Research

Rebalancing is essential for future growth: even as GDP has grown, consumption's share has declined



Source: Haver Analytics, Deutsche Bank Research

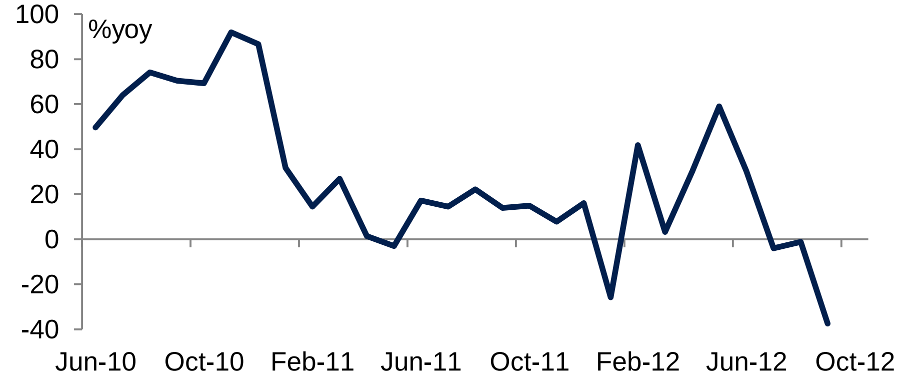
- Recovery in China likely to come sooner than expected, and we continue to anticipate strong growth in H2 2013
- GDP to recover modestly to 7.7% in Q4
  - Reduced political uncertainty
  - End of inventory destocking
  - Credit growth starting to improve
- Growth to return to its potential rate (at about 8.5%) in the H2 2013
  - Capacity utilisation recovers following period of corporate disinvestment
  - Private sector recovery
- Expect more clarity on the makeup of the new government by mid-November
  - Likely to be growth and investment friendly
  - Policy uncertainty to be lifted, supportive for growth

China Strategy: A U-shaped recovery and Q4 catalysts

Japan / China tensions have negatively impacted Japan (and benefited Europeans) but will likely not escalate

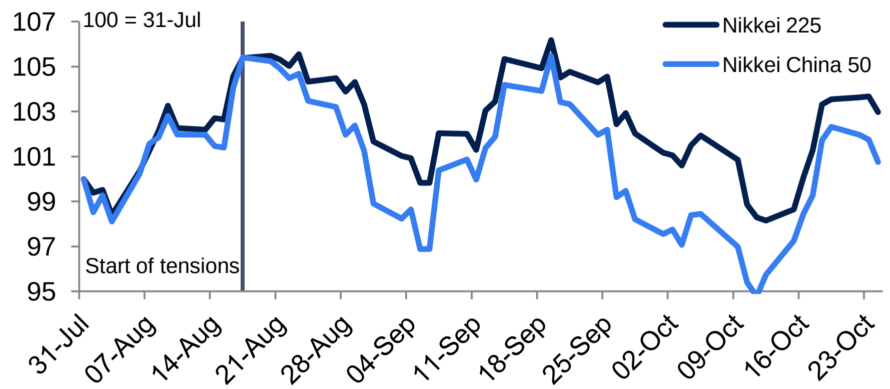
- **Tensions between the world's 2nd and 3rd largest economies have had a significant impact**
  - Greater impact than earlier tensions in '05 and '10
  - Have seen demonstrations, but more importantly boycotts of Japanese products and plant closures
  - Main Japanese losers in automotive, electronics, general machinery sectors
  - More generally, China-exposed Japanese stocks have underperformed
- Prolonged tensions could see European firms benefit – e.g., German carmakers already gaining share
- **However, neither Japan nor China has a genuine interest in escalating the conflict**
  - Japanese economy increasingly dependent on China – from a trade point of view (imports and exports) and as a key part of its supply chain
  - Japanese firms like Uniqlo and Mitsubishi have affirmed their plans to continue investing in China
  - China, during its delicate leadership transition, will also likely refrain from making this a bigger issue

Japanese car sales* in China plunge



*total vehicle sales of Toyota, Nissan, Honda, Mazda and Suzuki in China
Source: Bloomberg Finance LP, Deutsche Bank Research

Japanese companies with exposure to China have underperformed since the start of the tensions in August

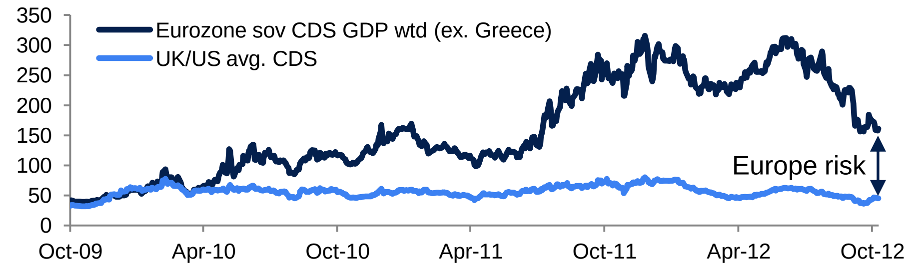


Note: Nikkei China 50 comprises 50 large Japanese firms with high exposure to China
Source: Bloomberg Finance LP, Deutsche Bank Research

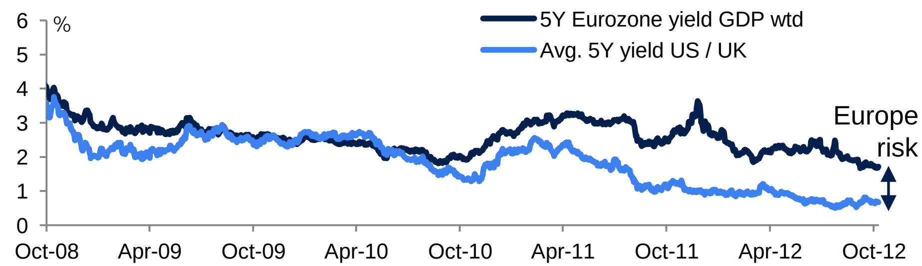
Eurozone assets incorporate a significant sovereign-related risk premium – its likely fall in the next few months should be supportive

- **Eurozone risk premium remains high** due to the lack of fiscal integration and lingering breakup concerns
  - Despite Q3 rally, equities trade at discount relative to forward earnings (11.1x vs. 12.5x fair value)
- **We expect this Eurozone risk premium to fall over time**
  - Reduction of imbalances underway
  - ECB / ESM provide a (weak) form of fiscal union
  - Growth bottoming out and likely to surprise to the upside given bleak outlook currently priced in
- **Euro area risk assets to outperform over the coming months**
  - **EUR** to rally vs. USD, CHF and GBP
  - **Credit**: sovereign CDS to tighten, prefer senior secured financial in the periphery, subordinated financial in core
  - **Equities**: prefer value over growth stocks – favour banks, insurance, telecom and energy
- **Key short-term risk: Spain delaying aid request** – hedge: short Spain front-end

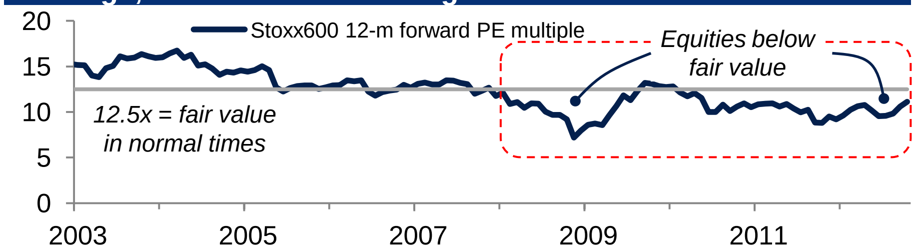
The Eurozone GDP weighted sovereign CDS remain elevated compared to the US and UK…



…as do government bond yields



European equities are still trading at a discount vs. forward earnings, as a result of sovereign risk



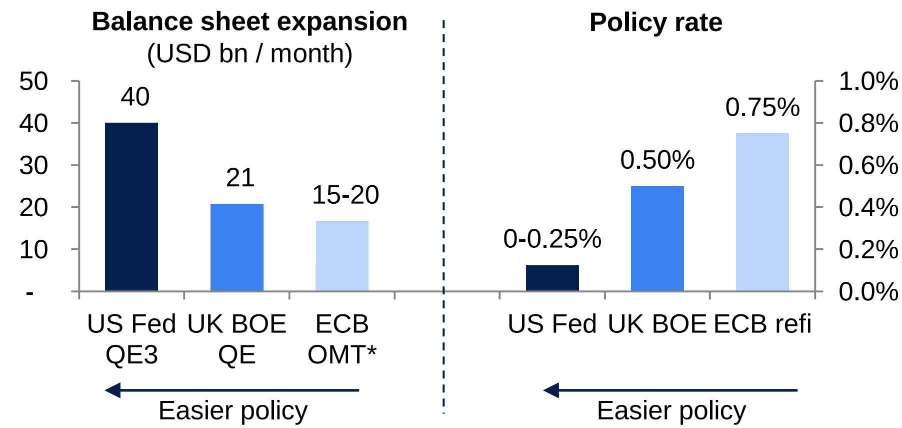
Source: Bloomberg Finance LP, DataStream, Deutsche Bank Research

Rates and Credit Weekly 12 Oct 12

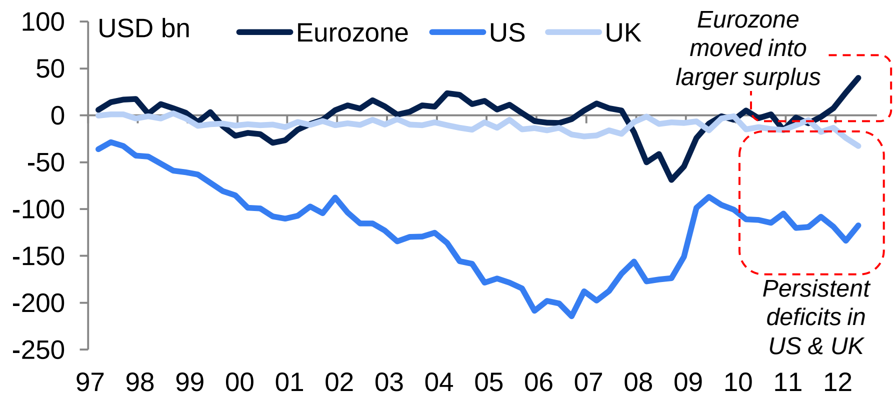
We are long EUR (vs. USD, GBP, CHF) due to relatively tighter monetary policy and stronger fundamentals

- Bullish EUR vs. USD (target 1.35), GBP (0.85) and CHF (1.25)
- **"Risk premium" on the euro is still substantial and has room to contract**
- **Easier monetary policy in US / UK than Eurozone** favours EUR strength
  - US Fed, UK BOE QE larger than potential ECB purchases
  - Lower policy interest rates in the US and UK
  - Fed committed to loose policy; ECB policy easy too, but unlikely to get negative deposit rate or new LTRO
  - ECB likely to abandon easy policy before Fed
- **Stronger fundamentals in Eurozone**
  - Eurozone current account shifted to surplus – vs. persistent deficits in US, UK
  - No evidence of capital flight in portfolio flows
- **Strength vs. CHF driven by partial reversal of inflows** to Switzerland in the summer (EUR140bn+)

Monetary policy easier in US / UK, with faster balance sheet expansion and lower policy rates



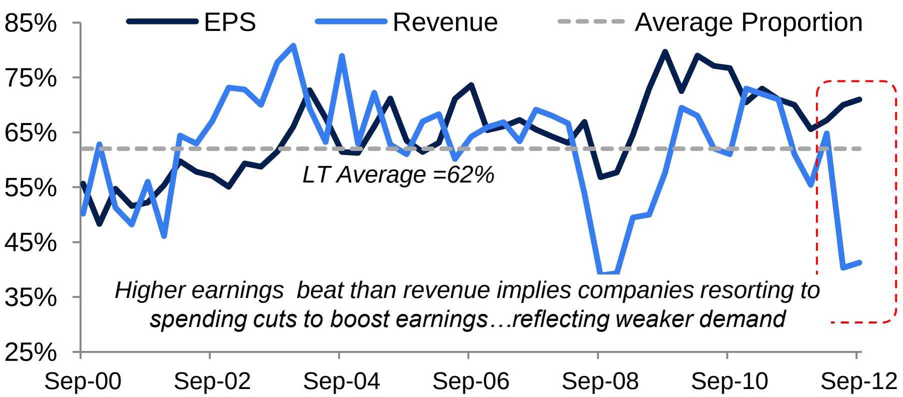
Stronger fundamentals in Europe: Eurozone current account moving into larger surplus, vs. persistent deficits in US and UK



Note: (*) Expected. OMT has been presented but has not yet been used, as Spain, Italy have not yet requested aid
Source: Haver analytics, Bloomberg Finance LP, IMF, US Fed, UK BOE, ECB, Deutsche Bank Research

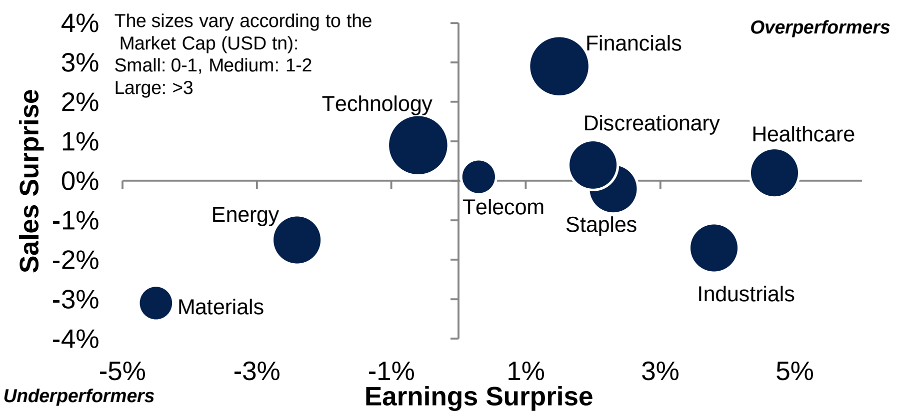
Although US Q3 earnings are shaping up to be the worst since the recession, we expect them to rebound in Q4

Proportion of S&P 500 companies beating estimates



Source: Bloomberg Finance LP, Deutsche Bank Research

S&P 500: Q3 Earnings weighted surprise Matrix: Big-cap Tech and capital markets exposed Financial stocks are attractive now



Source: Thomson Reuters, Deutsche Bank Research

- Q3 earnings likely to be the worst **worst since the recession**
  - **70% of companies have beat EPS estimates**, but only **41% have exceeded revenue estimates**, well below the long term avg. of 62%
  - Companies continue to manage down costs (inventories, headcount and capacity)
- **Earnings momentum has slowed**
  - EPS growth likely to be flat vs. 8% in recent quarters. Excluding Financials, EPS is -3%
  - Q3 EPS beats likely to be ~1%, vs. 2-4% for the past several quarters
- **Weak Q3 sales growth** is a key cause for concern; we think this concern is overdone
  - Expect y/y sales growth of 2-3% despite a nearly 2% FX headwind (strong USD), soft commodity prices and capital markets; these drags should stop or become tailwinds in Q4
- Interestingly, we're seeing the **reverse in Europe,** albeit very early in the reporting season
  - Of the Stoxx 600 companies that have reported: only **36% have beat on earnings** expectations, but **51% have beat on sales**

US Equity Insights - Poor 3Q EPS, but not a disaster: Now is a fair S&P 500 entry point 25 Oct 12

DB Forecasts

GDP Growth (%)

	2011	2012F	2013F	2014F
Global	3.7	2.9	3.2	3.8
US	1.8	2.1	2.0	3.1
Euroland	1.4	-0.5	0.0	1.0
Germany	3.1	0.8	0.8	1.5
Japan	-0.7	1.9	0.6	0.5
UK	0.8	-0.3	1.0	1.8
China	9.3	7.7	8.2	8.0
India	7.9	5.6	6.7	7.0
EM (Asia)	7.5	6.1	6.7	6.9
EM (Lat Am)	4.2	2.9	3.9	4.0
EM (CEEMEA)	4.7	3.0	3.6	4.0
EM	6.3	4.8	5.5	5.7
DM	1.3	1.2	1.2	2.0

Key Market Metrics

		Current	Q4 ’12	Q1 ’13	Q3 ’13
US 10Y yield	%	1.83	2.00	2.50	-
EUR 10Y yield	%	1.60	1.75	2.00	2.50
EUR/USD		1.30	1.35	1.31	1.24
USD/JPY		80	82	84	88
S&P500		1409	1475	-	1500
STOXX 600		271	275	-	-
Gold	$/oz	1713	1850	1950	2300
Oil WTI	$/bbl	87	100	100	108
Oil Brent	$/bbl	109	115	110	115

*Current prices as of 25October, 13:30 GMT

CPI Inflation, YoY* (%)

	2011	2012F	2013F	2014F
US	3.1	2.1	2.4	2.6
Euroland	2.7	2.5	1.8	1.7
Japan	-0.3	0.1	-0.5	1.7
UK	4.5	2.8	2.3	1.9
China	5.4	2.8	3.2	3.0
India	9.5	7.4	6.8	6.4

Central Bank Policy Rate (%)

	Current	Dec’12	Mar’13	Sep’13
US	0-0.25	0-0.25	0-0.25	0-0.25
Euroland	0.75	0.75	0.50	0.50
Japan	0.10	0.10	0.10	0.10
UK	0.50	0.50	0.50	0.50
China	3.00	3.00	3.00	3.00
India	8.00	8.00	7.75	7.00

*CPI (%) forecasts are period averages.
CEEMEA: Czech Rep., Hungary, Poland, Russia, Turkey, South Africa, Israel, Romania, Kazakhstan, Ukraine, Egypt, Saudi Arabia and UAE.
LATAM: Argentina, Brazil, Chile, Colombia, Mexico, Venezuela.
ASIA: China, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand.
DM: US, Japan, Euro area, UK, Denmark, Norway, Sweden, Canada, Australia, New Zealand, Switzerland.

Appendix 1
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Attribution

The Author of this report wishes to acknowledge the contributions made by Shakun Guleria and Pravin Kumar, employees of Infosys Technologies Ltd., a third party provider to Deutsche bank offshore research support services.

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