EQUITY RESEARCH
2015 KEY PREDICTIONS
HAPPY NEW YEAR!!

COLLINS SARRI STATHAM
INVESTMENTS

Research Report

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Analyst
Ravi Lockyer MSc Llb

Collins Sarri Statham Investments Ltd

How did our forecasts for 2014 do?

Index	2014 (Market Close 19 Dec 14)	2014 forecast (from 9 Dec 13)	Dec 19 (variance from 2014 forecast)
FTSE 100	6,545.3	7,000	- 454.7 (-6.5%)
FTSE 250	15,888.9	16,000	- 111.1 (-0.7%)
CAC-40	4,250.8	4,700	- 449.2 (-9.6%)
DAX 30	9794.3	9,500	+ 294.3 (+3.1%)
Dow Jones	17804.8	17,500	+304.8 (+ 1.7%)
Nikkei- 255	17,621	17,500	+ 121 (+0.7%)

I was more positive on 2014 than it turned out, so guilty of being a bit too optimistic, but was very close on the Dow Jones. I still see value in UK stocks as measured both by multiple and price to cash flow so please see my 2015 predictions below. These are more measured than for 2014.

The recent volatility represents some investor wariness over geopolitical issues and extreme movements in commodity prices. Both factors impact the FTSE 100's high weighting in mining (7.7%) and petroleum (14.1%). Relative to the Dow Jones, the FTSE 100 has lagged a bit, and has yet to exceed its Millennium Eve highs of 6930.

Geopolitical events dominated in 2014

2014 saw a number of major issues emerge that impacted investor sentiment:

i) A game of brinkmanship has emerged centred around Russian support for the Ukrainian separatist movement in Donetsk. Despite significant sanctions related pressures on the Russian economy, there is no sign yet of a policy change. The Rouble movement from RUB35/ US Dollar before the MH17 tragedy to over RUB70 speaks volumes about the lack of confidence in the Kremlin's economic management and it risks an inflationary surge in 2015. The Bank of Russia's reserves ($416bn) have depleted by about one fifth over 2014 due to efforts to smooth the decline.

ii) After over four decades of price targets and production quotas, the OPEC leadership made a historic decision on October 27th to let the oil market find equilibrium i.e. the point where supply = demand and there is no unsold inventory. Lower oil prices will eventually choke off expensive supply in theory. However excess supply caused by US shale oil, higher output from Libya and Iraq (the Kurds can now export 550k bbls per day) could mean oil supply exceeds demand.

iii) The UK is more politically complex place ahead of May's General Election. Despite the lost Independence vote, the SNP will make inroads into Labour's vote in Scotland with UKIP gaining at the expense of the Conservatives in the North/ Midlands.

Key Risks to Price Target

i) Global equity valuations are dependent on lax monetary policies remaining in place.

ii) Global investing conditions are highly volatile.

iii) Expectations of improving economic conditions in a number of countries are priced in to current valuations.

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What about 2015?

In terms of economic / political developments my key predictions are:-

i) China – GDP growth over 2015 to slow to 6.25% from 7.2% ie a “soft landing”
ii) Iron Ore – to decline to around $60/ MT from $70/ MT
iii) Rally in West Texas Instrument (WTI) crude oil prices to $60/bbl to $70/bbl
iv) UK GDP growth to moderate to 2.5% in 2015
v) UK Base rates to end 2015 at 0.75%
vi) GBP/USD1.65 ; GBP/ EUR 1.25
vii) UK General Election – another Conservative/ Liberal coalition emerges, the Tories obtain a very small majority but decide a Coalition will give the government a working majority.
viii) US Federal Reserve alters the Fed funds rate in Q3 with a modest tweak to 0.25%.
ix) Stagnant/ lower UK property prices with price declines of c.5% in the UK and between 5%-10% in London
x) 3% GDP contraction in Russian GDP

Themes

i) Oil service companies – the hardest hit sector should recover as oil major capex budgets clarify over 2015. I think the oil services sector has oversold but clarity on budgets will only arrive mid-2015.
ii) Lower oil price – beneficiaries typically in the leisure / transport sector will benefit from cheaper crude oil as hedges expire.
iii) China – Chinese equities, whilst broadly positive I recommend taking a diversified approach via China focused investment trusts.
iv) Banks should benefit from the rate cycle turn (higher interest spreads) when it occurs in the second half of 2014.
v) House builders – a calming down in £1m+ bracket (due to stamp duty changes) is likely to impact higher end suppliers.

Conclusion

Where do I see global equities in 2015?

Index	**2015 forecast**	**Comment**
FTSE 100	6,750	Negative effect pre-election but a jump post. P/E 14.5x ok
FTSE 250	16,000	Little progress 17.7x P/E a bit rich – a 4% gain expected
CAC 40	4,500	Lower EUR a positive, reform agenda underway finally
DAX 30	9,500	Flat year for DAX due to Russia/ BRIC contagion
Dow Jones	17,000	Higher Fed funds/ higher USD / weaker global market/ lower oil earnings will impact US equity market
Nikkei- 255	18,000	Japan Prime Minister Shinzo Abe reforms to start/ low Yen will help exporters

Investors need to remember that “equities climb a wall of worry” – there has been decent GDP acceleration in both the UK and USA in 2014 and a lax monetary environment remains in place, and is likely to only be tinkered with in 2015. I am keen on a “buy the dips” approach for UK equities particularly since bond yields (10 Year gilt 1.83%) and cash deposit rates are offering almost negligible returns.

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Collins Sarri Statham Investments Ltd. 6th Floor 5 Lloyds Avenue London EC3N 3AE
Telephone: +44 (0)20 7264 2360 Facsimile: +44 (0)20 7264 2361 www.css-investments.com Email: info@css-investments.com