



**S&P
CAPITAL IQ**

McGRAW HILL FINANCIAL

Equity Market Pulse

Quantamental Research

- *Global Trends in Equity Market Fundamentals*
- *Performance in Regional Equity Markets*
- *Regional Investment Style Returns*
- *Quantamental Investment Research*

Q4 2014

ISSUE 2

Introduction

Driven by S&P Capital IQ's™ proprietary data and analytics, Equity Market Pulse provides professional investors with insights into global equity market fundamentals and performance at a glance. Spanning developed and emerging markets in the Americas, Europe, and Asia, it provides perspective on valuations, operating efficiency, and investment strategy effectiveness. The analysis is broken into four themes:

Operating Performance—Trends in operating performance with return on equity deconstructed into: net profit margins, asset turnover, and financial leverage.

Valuation—Analysis of valuation multiples coupled with consensus outlook for earnings and revenue growth.

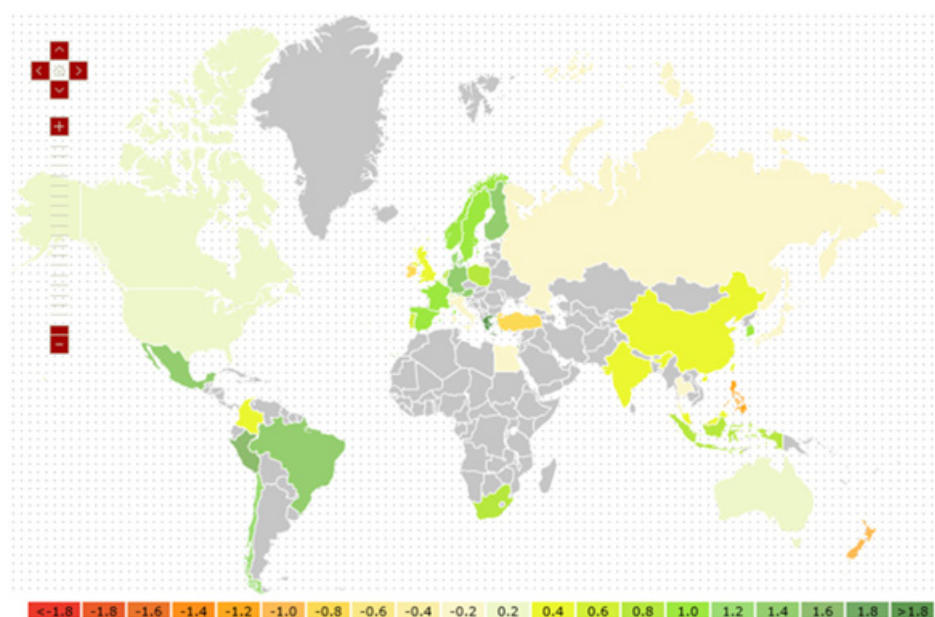
Risk And Return—Tracks the dynamics of equity market returns and volatility.

Strategy Returns—Examines the performance of eight common investment strategies employed by global investors.

Executive Summary

- The S&P 500® continues to be the preeminent regional performer in terms of both financial results and price appreciation, with the highest return on equity (ROE) of all nine regions and a year-to-date total return second only to Emerging Asia.
- Investor preference for developed markets continues, as developed markets show rising P/E multiples versus the emerging markets on much stronger financial performance. Developed markets saw year-to-year increases in ROE and net profit margin, while emerging markets saw declines in ROE, profit margins, and asset turnover.
- Emerging markets appear cheap on a valuation-to-projected-growth basis, with forward P/E to earnings growth (PEG) ratios of less than half those of the developed market average.
- S&P Capital IQ's factor library results show fundamental-based investment strategies outperforming across geographical regions, with price and size-based strategies consistently underperforming YTD. We see this dichotomy reflecting decreased investor appetite for risk and increased selectivity, as the global bull market ages.
- Japan is showing improvement in net profit margin growth and sales volume, as well as a decrease in stock price volatility. Japan has lagged the global economy for some time and, with the second lowest ROE of all regions, in our view has substantial room for improvement.

Net Profit Margin—Excess Returns of Top 20% of Stocks Year to Date as of 11/14/2014



Authors

Richard Tortoriello
Analyst
Quantamental Research
S&P Capital IQ

Paul Fruin, CFA
Analyst
Quantamental Research
S&P Capital IQ

If you wish to contact the authors with questions, please email equitymarketpulse@spcapitaliq.com

Global Trends In Equity Market Fundamentals

OPERATING PERFORMANCE: RETURN ON EQUITY ANALYSIS

Dupont Analysis: Return On Equity = Net Profit Margin * Asset Turnover * Leverage

Americas		S&P 500		S&P TSX		Latin America	
		Current	October 2013	Current	October 2013	Current	October 2013
Return on Equity	[Profit / Equity]	15.2% ▲	14.4%	9.6% ▲	8.7%	9.2% ▼	10.1%
Net Profit Margin**	[Profit / Sales]	9.7%	8.8%	7.7%	7.4%	8.4%	8.9%
Turnover	[Sales / Assets]	0.35	0.35	0.17	0.16	0.26	0.28
Leverage	[Assets / Equity]	4.5	4.6	7.5	7.3	4.2	4.1
Europe		United Kingdom		Europe DM exUK		Europe EM	
		Current	October 2013	Current	October 2013	Current	October 2013
Return on Equity	[Profit / Equity]	13.1% ▲	12.1%	8.6% ▲	8.5%	8.2% ▼	11.7%
Net Profit Margin**	[Profit / Sales]	7.0%	6.4%	5.1%	4.8%	7.9%	11.1%
Turnover	[Sales / Assets]	0.27	0.28	0.22	0.22	0.32	0.37
Leverage	[Assets / Equity]	7.0	6.7	7.7	8.1	3.2	2.9
Asia		Japan		Asia DM exJapan		Asia EM	
		Current	October 2013	Current	October 2013	Current	October 2013
Return on Equity	[Profit / Equity]	8.3% ▲	7.9%	10.4% ▼	10.5%	14.7% ▼	14.9%
Net Profit Margin**	[Profit / Sales]	4.5%	4.3%	8.3%	8.3%	10.7%	10.4%
Turnover	[Sales / Assets]	0.33	0.32	0.33	0.31	0.18	0.19
Leverage	[Assets / Equity]	5.7	5.7	3.8	4.1	7.7	7.6

*Note: Highlighted cells are noteworthy changes to components of ROE, as discussed in the commentary below.

**Profits are measured as income from continuing operations, excluding extraordinary items

Source: S&P Capital IQ Quantamental Research

- **ROE in developed markets increased almost across the board, aided by rising profit margins for the 12 months ended October 2014.**
 - **United Kingdom** ROE rose 110 basis points on profit margin and leverage increases, as real GDP (in USD)¹ trended upwards, averaging 3% for the first nine months of 2014.
 - **Canadian** ROE rose 80 basis points on improved margins, turnover, and leverage, with GDP growth rising from 1.6% in the first half of 2013 to a 2.3% average for the first half of 2014.
 - **S&P 500** ROE also rose 80 basis points as S&P 500 companies have continued to drive profit margins higher despite moderate growth in revenues and overall U.S. GDP.
 - **Japan** also saw a modest ROE rise [50 bps], on profit margin and asset turnover improvement.
- **ROE declined across the emerging markets, with asset turnover down in all three regions.**
 - **Emerging Europe** ROE dropped 400 basis points on lower turnover and profit margins. Russia dominates the S&P Europe Emerging BMI index (47% by market cap), and has been hurt by falling oil prices and economic sanctions.²
 - **Latin America** saw ROE decline by 80 basis points with Brazil and Mexico dominating the index. Both countries are significant oil and raw materials exporters, whose economies have been hurt in part by declining energy and commodities prices.

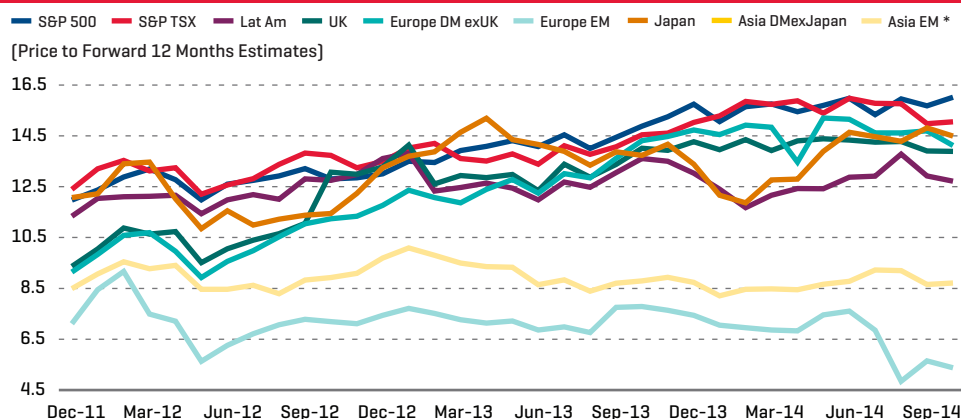
¹ Source: IHS Global Insight.

² Energy and materials stocks make up 40% of the S&P European Emerging BMI by market cap and over 20% of the S&P Latin America BMI.

Global Trends In Equity Market Fundamentals

VALUATION: PRICE TO FORWARD EARNINGS ANALYSIS

Regional Market Valuation As Of October 31, 2014



*Regional indices are comprised of all companies in the S&P BMI Global Indices for the region.
Source: S&P Capital IQ Quantamental Research.

- The U.S. is the only region with forward P/E ratios that continue to trend higher, reflecting positive investor reaction to continued strong S&P 500 corporate earnings growth.
- The gap between developed and emerging market P/E ratios remains quite wide, despite a recent sell-off across developed European stock markets.
- Japan P/E ratios have continued a steady climb begun in February of this year, as Bank of Japan monetary stimulus has boosted perceived economic growth prospects and added liquidity to the capital markets.
- On a P/E to Growth (PEG) basis, the emerging markets and Developed Europe have the most attractive valuation to growth ratios, with average PEG rates less than half of the developed market average.

Regional Market Metrics As Of October 31, 2014

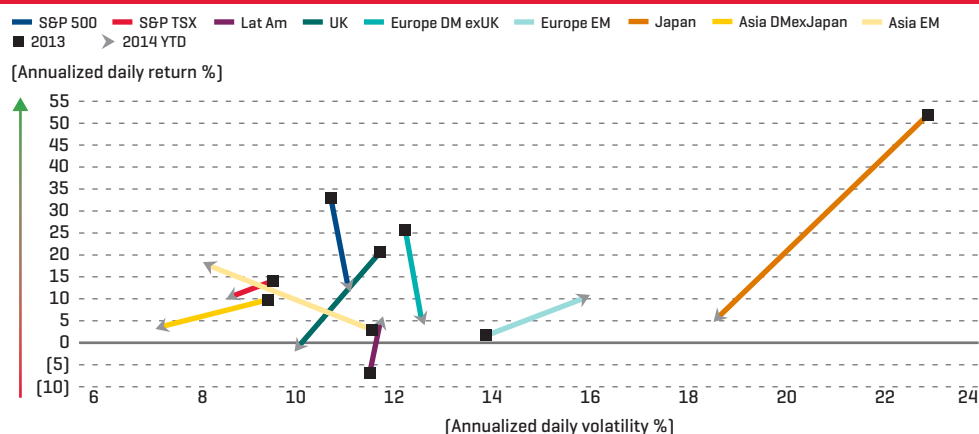
Americas	S&P 500	S&P TSX	Latin America
Price to FY1 Earnings Ests	17.3	16.1	13.4
Price to FY2 Earnings Ests	15.6	14.3	11.5
FY2/FY1 Est Earnings Growth	10.4%	12.9%	16.5%
P/E to Growth Ratio	1.5	1.1	0.7
FY2/FY1 Est Sales Growth	4.0%	4.7%	7.4%
Europe	United Kingdom	Europe DM exUK	Europe EM
Price to FY1 Earnings Ests	13.6	15.9	4.7
Price to FY2 Earnings Ests	12.7	13.7	4.2
FY2/FY1 Est Earnings Growth	6.3%	16.5%	10.9%
P/E to Growth Ratio	2.0	0.8	0.4
FY2/FY1 Est Sales Growth	1.1%	3.9%	5.5%
Asia	Japan	Asia DM exJapan	Asia EM
Price to FY1 Earnings Ests	14.8	13.7	10.1
Price to FY2 Earnings Ests	13.3	12.5	9.0
FY2/FY1 Est Earnings Growth	11.2%	9.4%	11.0%
P/E to Growth Ratio	1.2	1.3	0.8
FY2/FY1 Est Sales Growth	3.7%	6.0%	8.1%

Source: S&P Capital IQ Estimates and S&P Quantamental Research

Performance in Regional Equity Markets

RISK AND RETURN ACROSS REGIONS

Annualized Daily Volatility & Return As Of October 31, 2014



Indexes are unmanaged, statistical composites and it is not possible to invest directly in an index. The returns shown do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of fees and charges would cause actual performance to be lower. Past performance is no indication of future results.

Note: Annualized return and volatility are based on realized cap-weighted daily total returns in each region.
Source: S&P Capital IQ Quantamental Research.

- Emerging Asia is the only region year to date to have a combination of higher total returns [17.6% YTD annualized vs. 3.0% for 2013] and lower price volatility [8.6% vs. 11.9%]. This region is dominated by four countries: China [31% by market cap], India [22%], Taiwan [13%], and Hong Kong [12%].
- Latin America and Emerging Europe have both seen improved returns, but on higher volatility [more so in Emerging Europe than in Latin America].
- All other markets have recorded declining returns in 2014 versus 2013. However, Japan, the UK, and Developed Asia ex Japan have also seen significant declines in volatility, over the same period.
- The S&P 500 and Developed Europe ex UK have seen both significant declines in returns and modest increases in volatility.

HOW TO READ THE CHART: Each point on the chart represents a combination of annualized total returns [left scale] and annualized price volatility [bottom scale]. The lines show the change in return/volatility between 2013 and 2014 YTD. The arrow heads on the lines show the direction of travel.

Regional Investment Style Returns

Which styles have been the most [least] effective this year?

We compare the returns of top ranked stocks* by various investing metrics with the returns of the overall market year to date.

*Top ranked as defined by the top 20% of companies as ranked by the stated metrics

Investment Strategy Performance—Excess Returns of Top 20% Of Stocks* YTD As Of October 31, 2014

Representative Factor	Net Profit Margin	Trailing E/P	Trailing 1Y EPS Growth	Forecast EPS Revisions	Return on Equity	Market Cap	12M minus 1M Return	12M Return Volatility
Style	Earnings Quality	Valuation	Growth	Analyst Expectations	Capital Efficiency	Small Size	Price Momentum	High Volatility
S&P 500	0.2%	0.1%	[0.0%]	0.1%	[0.1%]	[0.0%]	[0.1%]	0.3%
S&P TSX	0.0%	0.6%	[0.3%]	[0.2%]	0.3%	0.3%	[0.6%]	[0.6%]
Latin America	1.2%	0.4%	1.1%	0.4%	0.4%	[1.4%]	0.9%	[1.2%]
United Kingdom	0.3%	0.6%	0.4%	0.5%	[0.0%]	0.1%	[0.3%]	[0.7%]
Europe Developed exUK	0.8%	0.5%	0.7%	0.4%	0.6%	[0.6%]	[0.0%]	[1.1%]
Europe Emerging	0.2%	[0.4%]	1.0%	[0.1%]	[0.2%]	0.0%	[1.0%]	[0.6%]
Japan	[0.1%]	0.2%	[0.5%]	[0.0%]	[0.2%]	0.2%	[0.5%]	[1.2%]
Asia Developed exJapan	0.4%	[0.4%]	0.1%	0.3%	[0.1%]	[0.8%]	1.0%	[1.1%]
Asia Emerging	0.6%	0.6%	0.4%	0.6%	0.6%	[0.4%]	[0.0%]	0.8%
Number of Regions Outperforming	8 of 9	7 of 9	6 of 9	6 of 9	4 of 9	4 of 9	2 of 9	2 of 9
<div> <div>OUTPERFORMING STRATEGIES</div> <div>UNDERPERFORMING STRATEGIES</div> </div>								

*Average 1 Month Return in excess of market for top 20% of stocks in that market
Source: S&P Capital IQ Quantamental Research

- The strongest of our eight key investment strategies year to date has been net profit margin (NPM), with average monthly excess returns for the top 20% of stocks by NPM of 0.4%, and especially strong performance in Latin America and Developed Europe.
- Fundamentally-based strategies (net profit margin, earnings to price, EPS growth, and EPS revision increases) have outperformed so far in 2014, signaling that investors have become more selective in purchases and more cautious about chasing returns.
- At the same time, investors have moved away from high volatility, high price-momentum, and smaller-cap stocks, reflecting a marked increase in risk-aversion and a decrease in price-trend following.
- Latin America strongly exemplifies this move away from risk, with strong increases in excess returns for net profit margin and growth-based strategies and strong decreases in excess returns from small caps and high volatility issues.

About S&P Capital IQ™ Equity Market Pulse

The content of the Equity Market Pulse is driven by S&P Capital IQ's fundamental data and analytics including S&P Capital IQ Estimates, Global Point-In-Time Fundamentals, and the Alpha Factor Library.

For more information about these and other data sets and analytical tools, please contact:

The Americas: +1 877-863-1306

Asia-Pacific: + 852 2533 3565

EMEA: +44 [0] 20 7176 1234

www.spcapitaliq.com

Quantamental Investment Research

OCTOBER 2014

[Lenders Lead, Owners Follow: The Relationship between Credit Indicators and Equity Returns](#)

Investors are continuously searching for profitable new investment opportunities. S&P Capital IQ Quantamental Research has been focused on exploring a class of strategies that originates from company specific events often overlooked by many investors. Because event driven strategies tend to be idiosyncratic, they are often complementary to common strategies employed by investors. We empirically examine the equity price response to two classes of fixed income events: changes in the opinions of Standard & Poor's Ratings Services' credit analysts and changes in Credit Default Spread [CDS] spread.

AUGUST 2014

[Equity Market Pulse](#)

Equity Market Pulse provides professional investors with insights into global equity market fundamentals and performance at a glance. Spanning developed and emerging markets in the Americas, Europe, and Asia, it provides perspective on valuations, operating efficiency, and investment strategy effectiveness. The content of the Equity Market Pulse is driven by S&P Capital IQ's fundamental data and analytics including S&P Capital IQ Estimates, Global Point-In-Time Fundamentals, and the Alpha Factor Library. The analysis is broken into four themes:

JULY 2014

[Factor Insight: Reducing the Downside of a Trend Following Strategy](#)

In this report, we review an approach that reduces the downside risk of a trend following strategy. This new signal first separates a stock's return into its systematic and stock-specific components, and then picks stocks solely on the latter. We compare the performance of this new signal [alpha momentum] to a typical trend following strategy [total momentum] and report the following:

- Globally, alpha momentum produces higher risk-adjusted returns in five developed market countries and a global universe. In the Russell 3000, alpha momentum's annualized long-short information ratio is twice that of total momentum [Jan 1988 – April 2014].
- Alpha momentum generates statistically significant excess returns in both large cap [Russell 1000] and small cap [Russell 2000] universes; total momentum's excess return is only statistically significant in the small cap segment.
- Alpha [total] momentum generates statistically significant average 1-month long-short spreads in eight [five] of nine GICS® sectors within the Russell 3000.
- The churn of both strategies is similar, suggesting that switching from total momentum to alpha momentum should not impact portfolio turnover materially.

MAY 2014

[Introducing S&P Capital IQ's Fundamental China A-Share Equity Risk Model](#)

Factor risk models play an important role in equity portfolio management. Portfolio managers depend upon factor risk models to obtain portfolio risk prediction and risk attribution against a group of largely orthogonal factors each with meaningful econometric explanations. S&P Capital IQ is dedicated to providing a broad set of high-quality models and products to the global asset management community. Since 2010, we have released a series of single country risk models as well as global and regional equity risk models. We are now releasing a new single country risk model covering China A-Share equities.

APRIL 2014

[Riding the Coattails of Activist Investors](#)

Can following the actions of activists be an effective strategy? Following the warm reception of our first paper on the topic 'Follow the Smart Money—Riding the Coattails of Activist Investors' published in March 2013, we are reissuing the paper by extending the time period to December 2013. Our findings indicate*:

- One-month after the commencement of activism, a backtested portfolio of targets yielded a market-adjusted return of 3.9%. After controlling for market, size, value, and industry, the excess return was 3.0%.
- Twelve-months after the disclosure of activist involvement, a backtested portfolio of targets produced an annualized excess return of 11.7% after controlling for market, size, value, and momentum.
- Our research finds no evidence that by utilizing Form 13F filings and taking positions in pre-disclosed targets prior to the commencement of activism, increased excess returns.
- Pre-activism, the targets tended to be [i] small-capitalization [ii] slow-growing [iii] low payout [iv] financially healthy.
- Post-activism, the targets were characterized by having [i] higher financial leverage [ii] lower cash holding [iii] higher payout [iv] no improvement to their financial operations.

MARCH 2014

[Insights from Academic Literature: Corporate Character, Trading Insights, & New Data Sources](#)

As part of our research process, we make a concerted effort to stay abreast of interesting white papers. Academic research papers are a rich source for new ideas and fine tuning of areas for future work. Often they provide a launch pad for debate and exploration for our team. In this piece we have assembled a number of interesting articles that we believe will be of broad interest to our clients, and all investment professionals—Corporate Character, Trading Insights & New Data Sources. For each article we provide a link to the article, the abstract, and a brief discussion of the article highlights and how it will be useful to fellow practitioners. It is our hope that these papers help you generate differentiated thinking, and to better serve your clients.

FEBRUARY 2014

Obtaining an Edge in Emerging Markets

Following the introduction of our global stock selection models for developed markets [DM] in August 2013, we launch our stock selection model for emerging markets [EM] and report the following*:

- The Model generated a top quintile average monthly excess return of 0.90% within the S&P BMI Emerging Market Index (Jan 2002–Sept 2013).
- The Model's performance is robust across regions and sectors.
- We do not observe performance degradation within mid to large cap stocks.
- Model's top quintile average monthly excess return is identical in growth and value environments [0.80%], and positive in periods of elevated volatility [0.53%].
- A backtested portfolio generated an annualized excess return of 10.5% after including hypothetical transactions costs.

JANUARY 2014

Buying Outperformance: Do share repurchase announcements lead to higher returns?

We examine the returns surrounding buyback announcements to test whether, and when, buyback programs signal subsequent outperformance and shareholder value. We find*:

- Buyback announcements precede excess returns in the US. Stocks on average outperformed the equally weighted Russell 3000 by 0.60% over one month, and by 1.38% over one year periods following buyback announcements.
- Outperformance is greatest among small caps or larger magnitude buybacks as a % of shares outstanding.
- Reported insider trading and buyback announcement signals are complementary.
- In Europe, some post-buyback outperformance over 12 months, but no significant excess return after one month.

*Backtested returns do not represent the results of actual trading and were constructed with the benefit of hindsight. Except for the Emerging Markets strategy, returns do not include payment of any sales charges or fees. Inclusion of fees and expenses would be lower. The Emerging Markets strategy includes hypothetical transaction costs. Past performance is not a guarantee of future results.

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