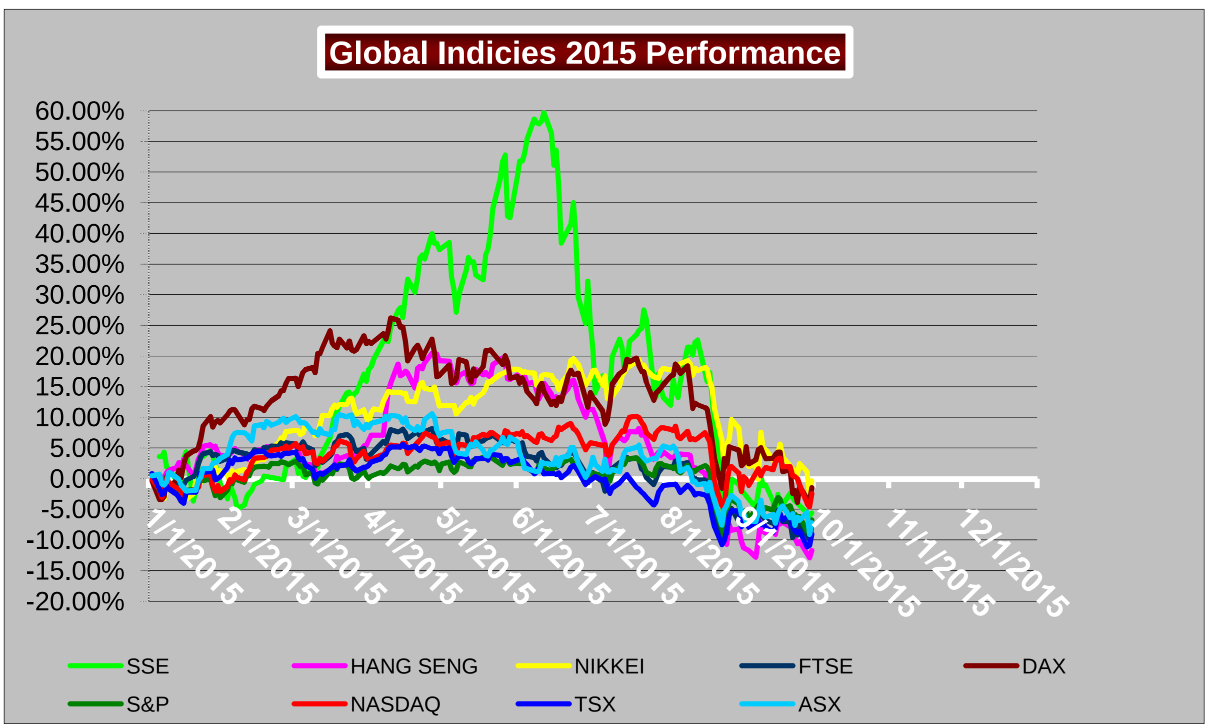
GDB October 2015 Newsletter

Monthly Market Summary:

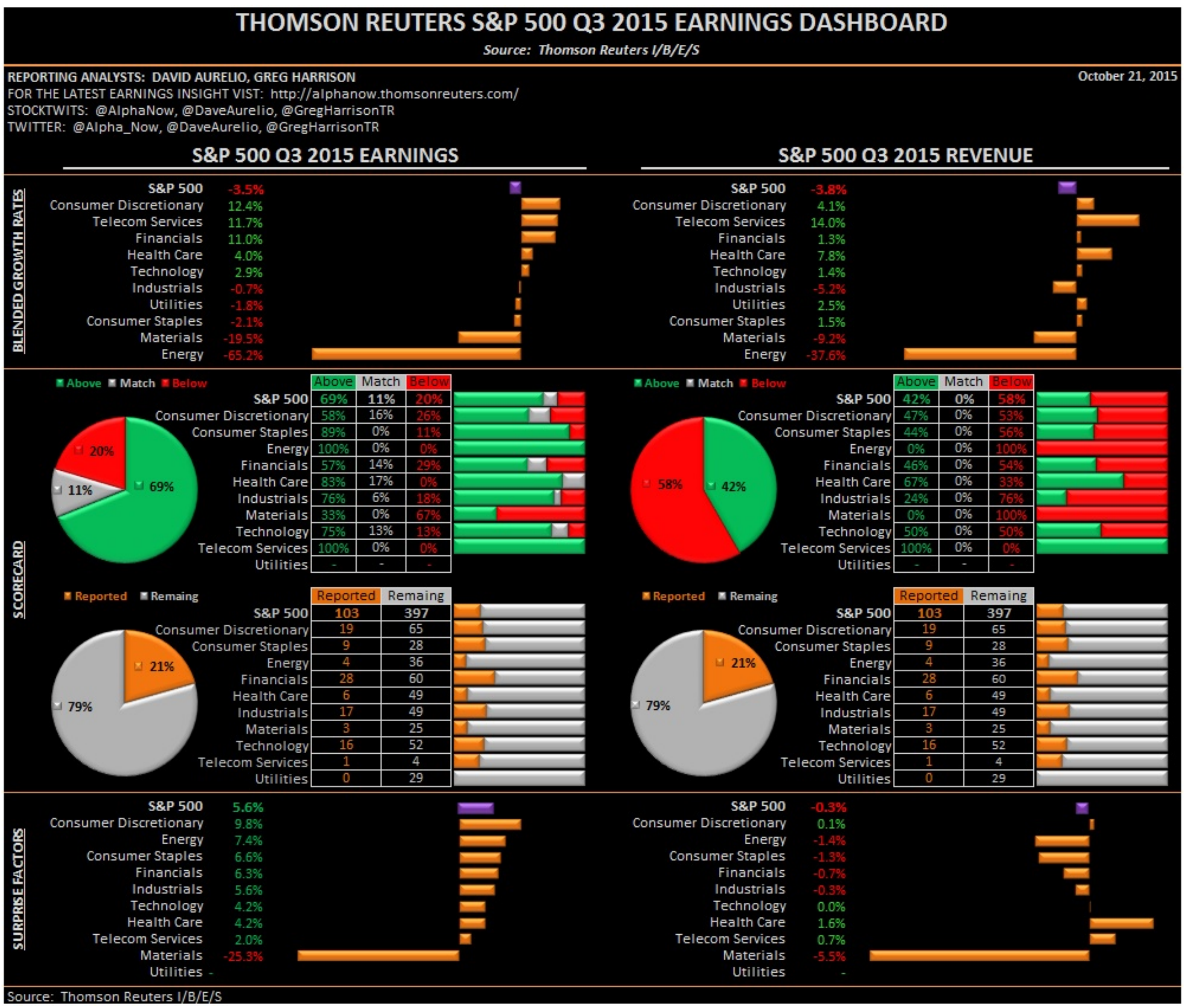
2015 September Market Activity		
SSE COMPOSITE	*3,052.78*	-153.12 (-4.78%)
HANG SENG	*20,846.30*	-824.28 (-3.80%)
NIKKEI 225	*17,388.15*	-1,502.33 (-7.95%)
FTSE 100	*6,061.60*	-186.30 (-2.98)
DAX	*9,660.44*	-599.02 (-5.84%)
DOW	*16,284.70*	-243.33 (-1.47%)
S&P 500	*1,920.03*	-52.15 (-2.64%)
NASDAQ COMPOSITE	*4,620.16*	-156.35 (-3.27%)
ASX 200	*5,021.60*	-185.40 (-3.56%)
TSX COMPOSITE	13,307.00	-552.10 (-3.98%)



Investment Themes:

After a wild ride in August and September, normality seems to have returned to the market in October. The S&P has returned to positive territory for the year, erasing the 10% plus correction we had seen during the last two months.

October is also the start of earnings season, of the 21% of the S&P 500 companies that have reported so far, 69% have reported earnings above the mean estimates, 11% in line, and 20% have missed targets. These figures are comparable to the last four quarters with 70% of the companies beating, 9% match, and 21% missed estimates. However, in terms of earnings growth, the blended earnings decline so far is -3.5% for Q3/2015. If the index reports a decline this quarter, it will mark the first back-to-back quarters of earnings declines since 2009.



In terms revenue, of all the companies reported so far, 42% have reported revenues above analyst expectations, and 58% below. Over the past four quarters 53% of the companies beat estimates and 47% missed estimates. The blended revenue decline for Q3/2015 is -3.8%.

While the scorecards so far are beating estimates, the contraction in both top and bottom lines continues to be the trend. Headwind such as global growth,wage inflation, and strength of US dollar will overshadow growth in the coming quarters, and analysts are not expecting growth to return until the first quarter of 2016.

At the sectors level, Information Technology (100%), Energy (100%), and Healthcare (83%), and are the sectors with the highest percentage of companies beating earnings estimates with no companies so far in these sectors missing targets. On the other hand, the Materials sector has seen the largest percentage of misses (67%) with the least percentage of companies beating estimates (33%). In terms of earnings growth, Consumer Discretionary and Telecom sectors are leading the way with 12.4% and 11.7% earnings growth respectively. Energy is reporting the largest YOY earnings decline of (-65.2%), followed by Materials with YOY earnings decline of (-19.5%). As mentioned earlier, the blended earnings growth rate for S&P so far is a decline of -3.5%; however, according to Factset, if we exclude the Energy sector, growth rate for the S&P 500 would jump to 2.8%.

Some of the macro themes that are observed during Q3/2015 are:

- US growth continues to be robust while conditions in China and Europe are challenging
- Strong US dollar is impacting foreign currency translations
- Average oil price for Q3/2015 ($46.53) was 48% lower than the average price year-ago quarter ($97.10). While it is negatively impacting the earnings for the Energy sector, the benefit of lower fuel prices for the other sectors is inconclusive
- Wage inflation is starting to creep into companies’ earnings

Overall, lower expectations are enabling companies to continue to meet targets. We don’t expect the estimates to be raised in the coming quarters as the current consensus are pushing any growth expectations well into 2016. The forward P/E Ratio of S&P500 is 16.0x, slightly above the 10-year average forward 12-momnth P/E of 14.1x. It is also above the forward P/E of 15.1 recorded at beginning of the quarter (September 30). Telecom is the only sector with a forward P/E below its 10 year average. Energy sector on the other hand, has the biggest discrepancy of forward P/E to the 10 year average (28.4x vs. 12.9x), indicating investors are expecting oil prices and earnings to rebound in a year time.

The lackluster earnings and slightly above average valuation of index are making us neutral on the US equity market going into the end of the year. Telecom sector seems to be the best performer with below average valuations. In terms of picking bottoms, we are more favorable towards the Materials sector over Energy. If the private sector does not drive growth in China and arguably some of the other developed economies, the government will drive growth through infrastructure spending, such as the AIIB. This will drive up the demand for raw materials and create tailwind for the much battered Materials sector.