Equity Research

Strategy

Darkest before the Dawn

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ABG SUNDAL COLLIER

Big Picture







Dichotomy of world economy to continue. China will be the positive surprise of 2023

Retail recession

Industrial cycle pointing down and an industrial recession likely

Capex Cycle in early days - strong corporate balance sheets

Peak in inflation and long term interest rates, lower real cost of capital ahead

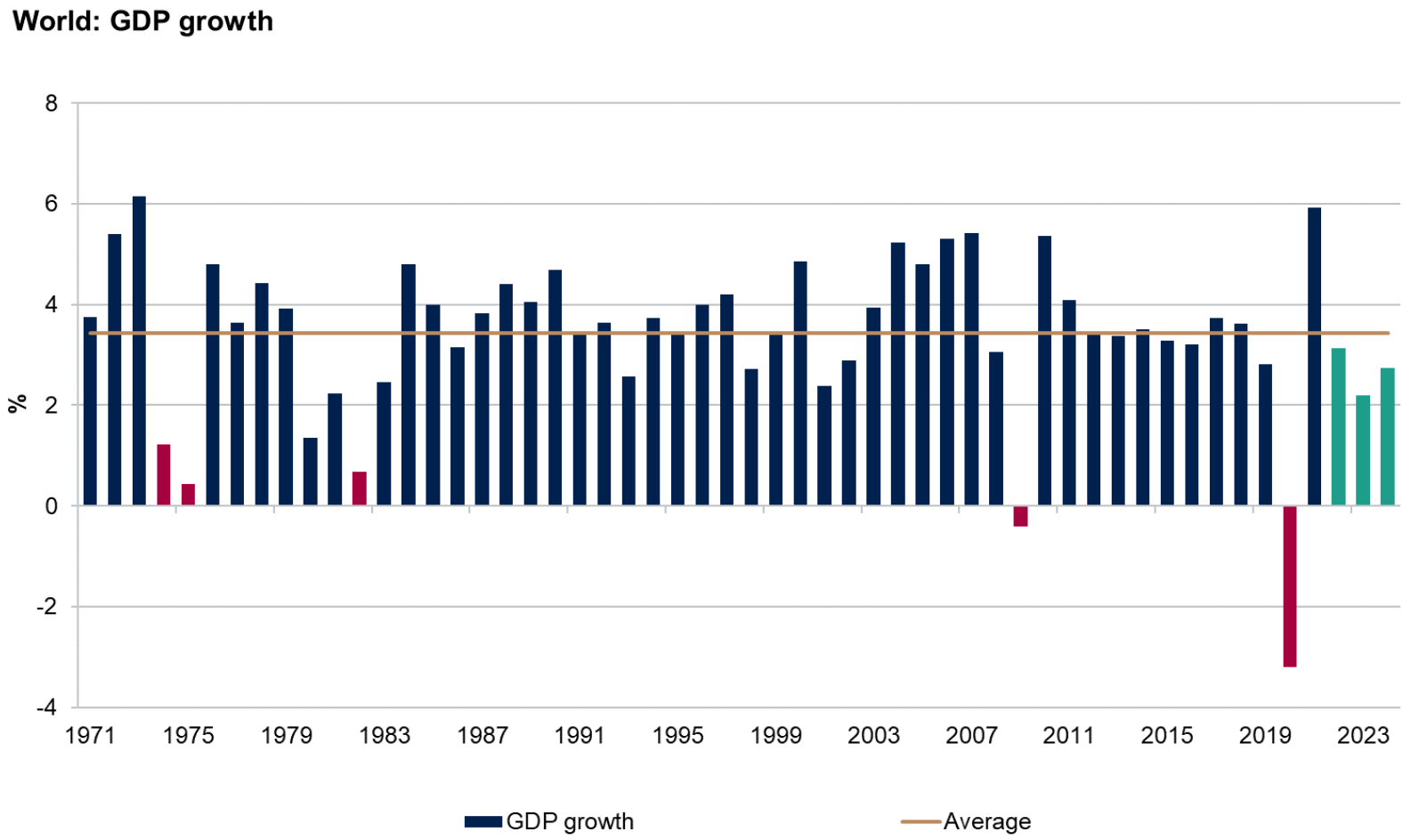
Close to peak in tightening cycle

Earnings are down, but likely to bottom out in H2’23

There is a strong case for equities next 12 months

Key risk – hard down turn if wage inflation is stubbornly high or energy crisis underpin inflation longer

Global GDP



Source: OECD, ABG Sundal Collier

Weak retail sales

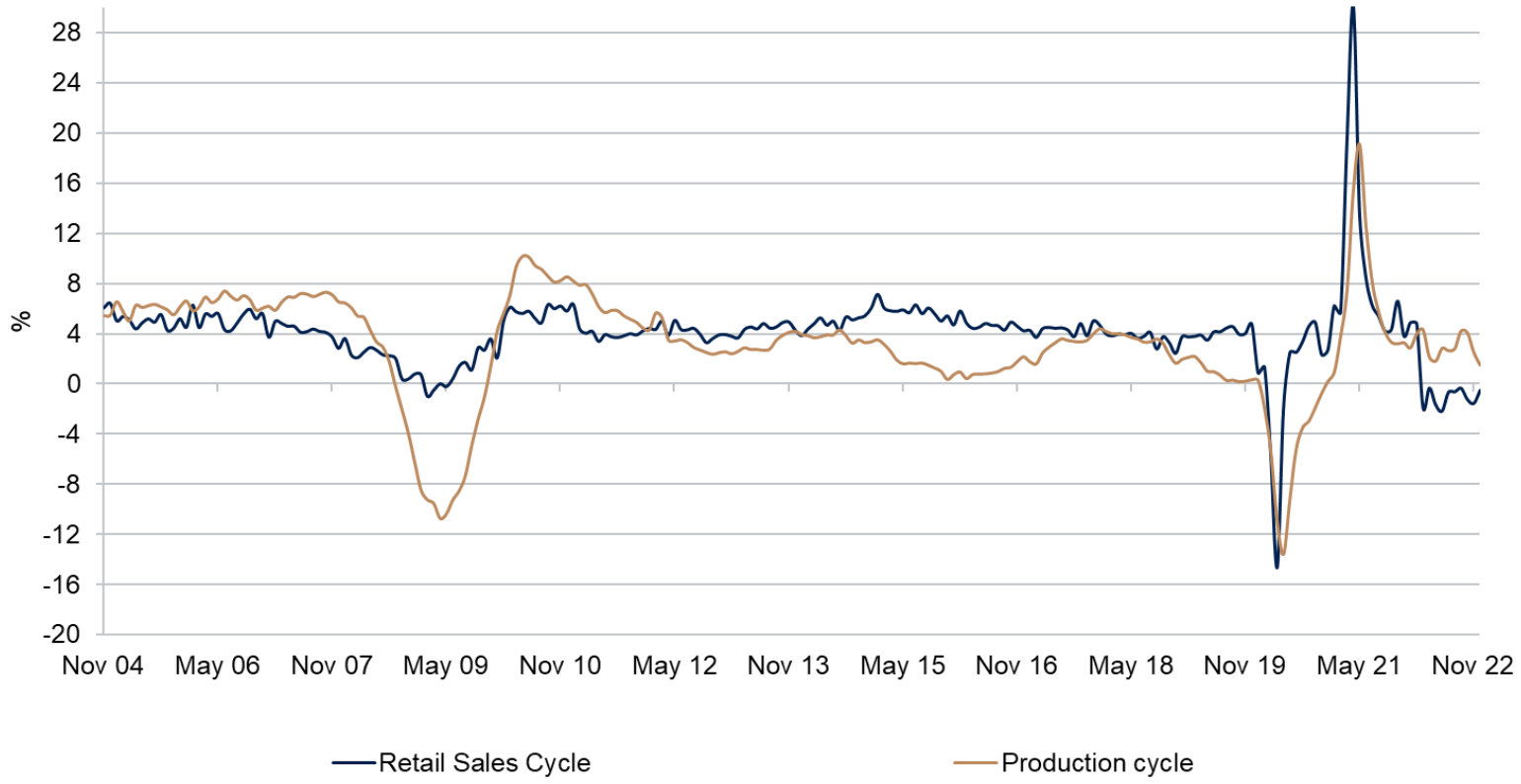
Global retail sales cycle (China, U.S., EU)



Source: ABG Sundal Collier

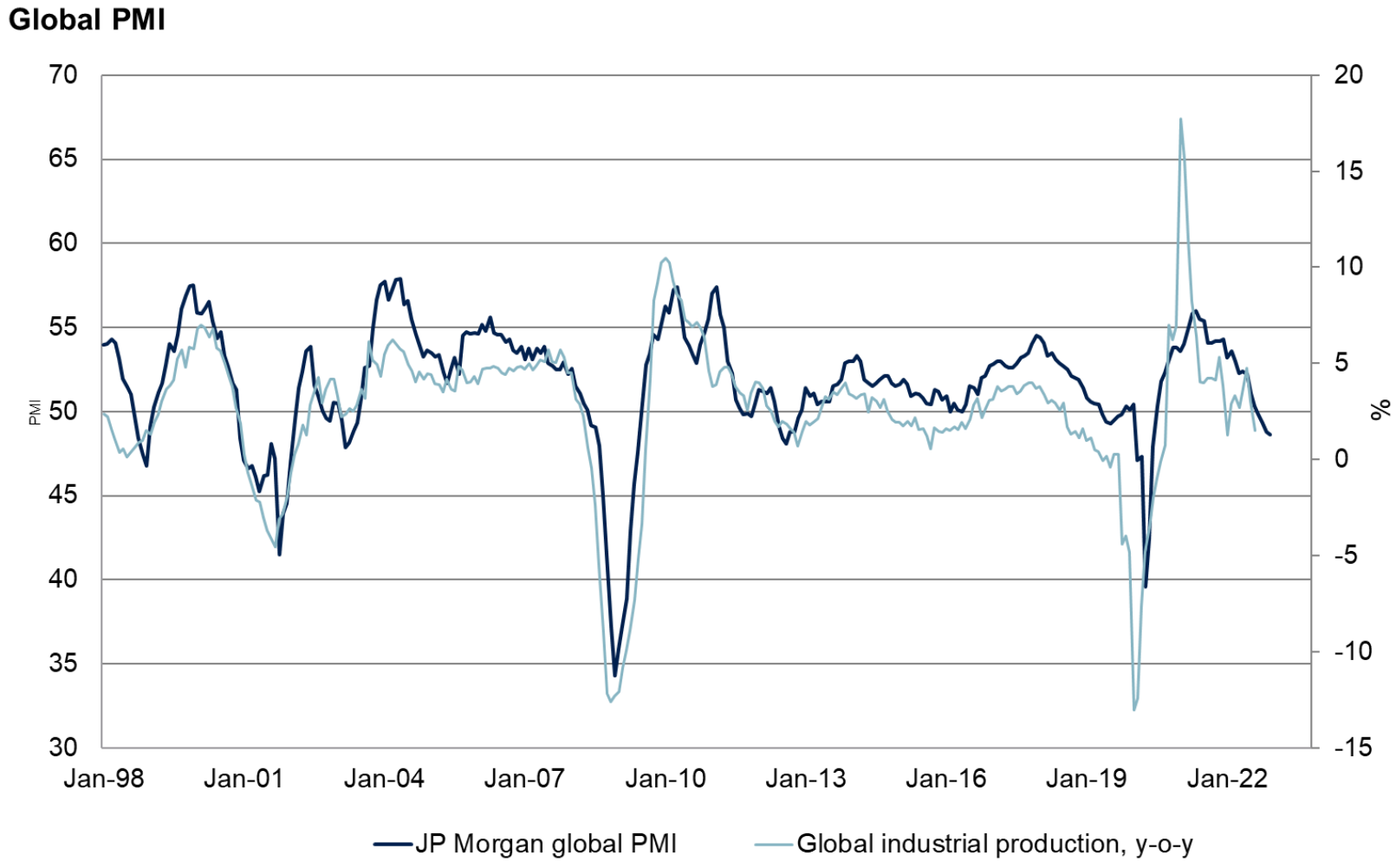
Weak retail sales, industrial production to follow

Global retail sales cycle and industrial production cycle (China, U.S., EU)



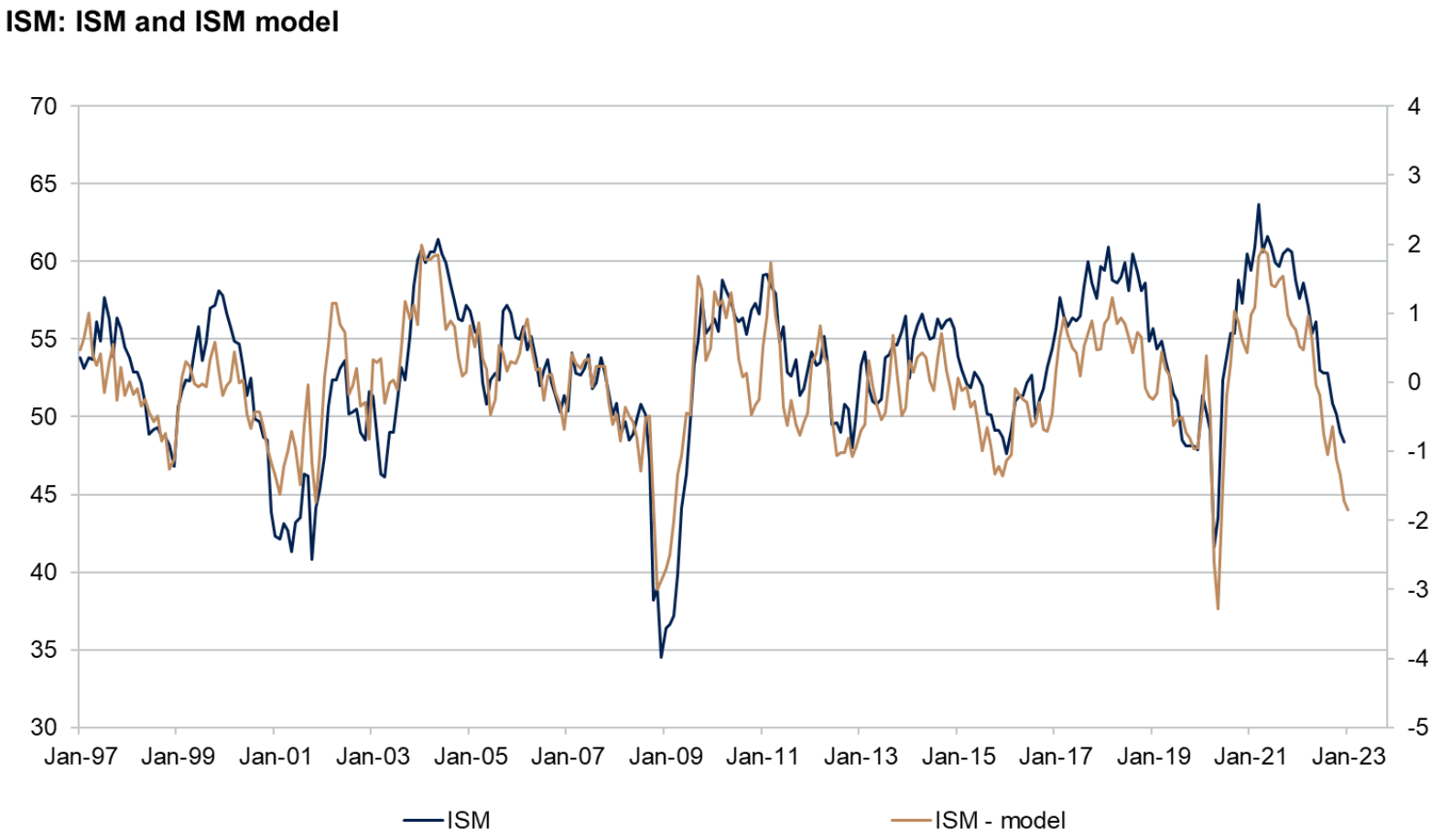
Source: ABG Sundal Collier

Slowly weakening PMI



Source: ABG Sundal Collier

US: ISM model points down

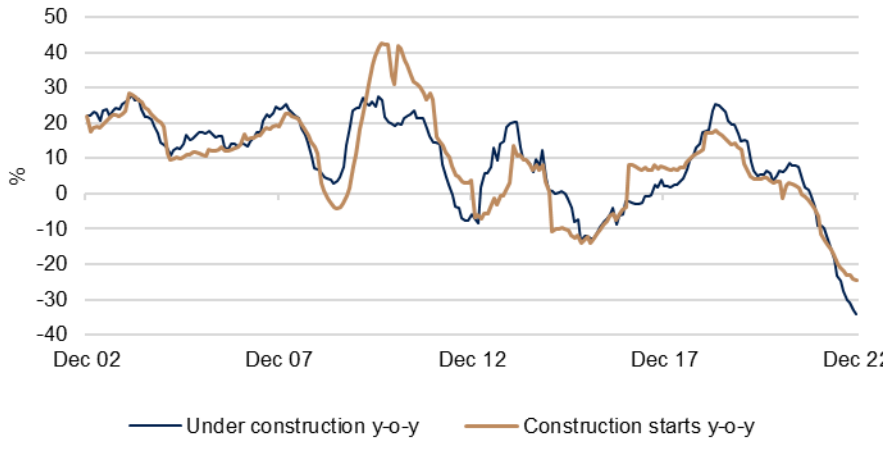


Source: ABG Sundal Collier

Source: Macrobond, ABG Sundal Collier

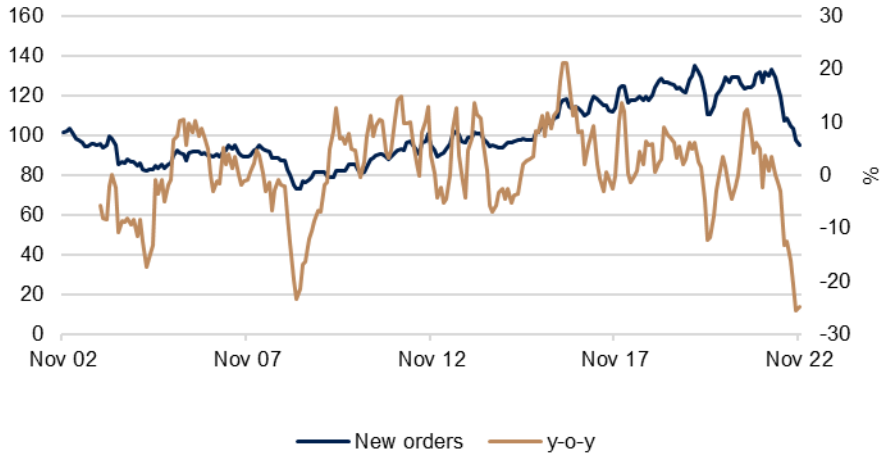
Construction major headwind – central banks hurts activity

China: Construction starts, sqm under construction



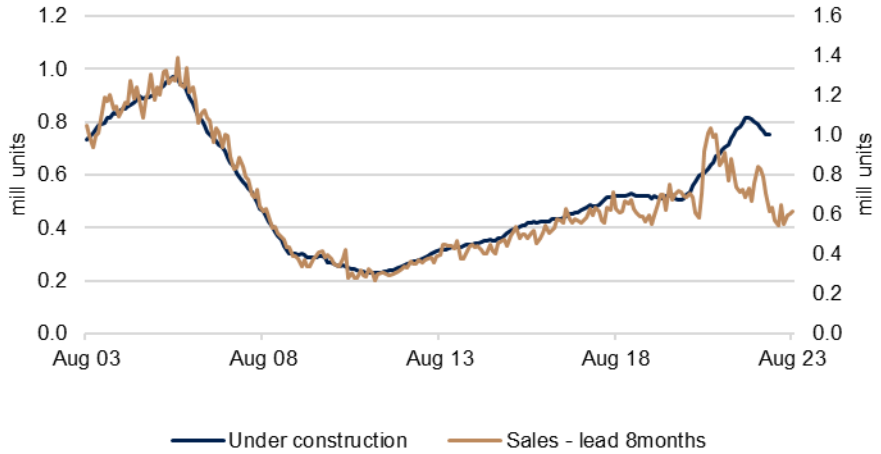
Source: Macrobond, ABG Sundal Collier

Germany: New orders construction



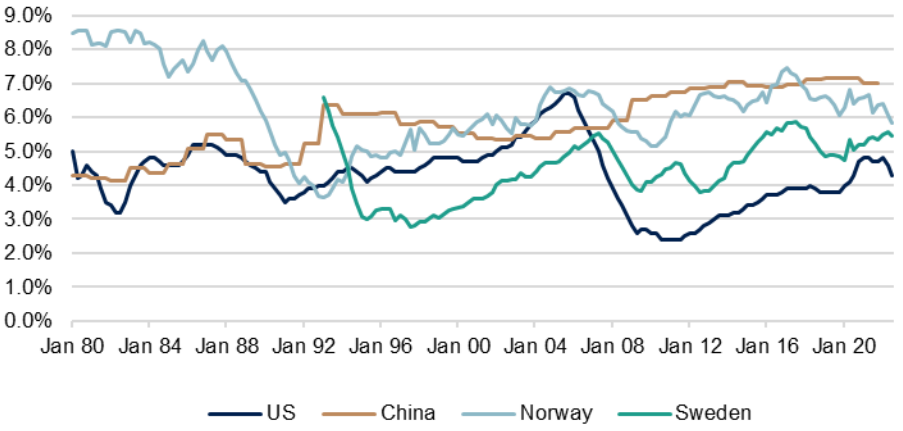
Source: Macrobond, ABG Sundal Collier

US: Houses under construction, sales



Source: Macrobond, ABG Sundal Collier

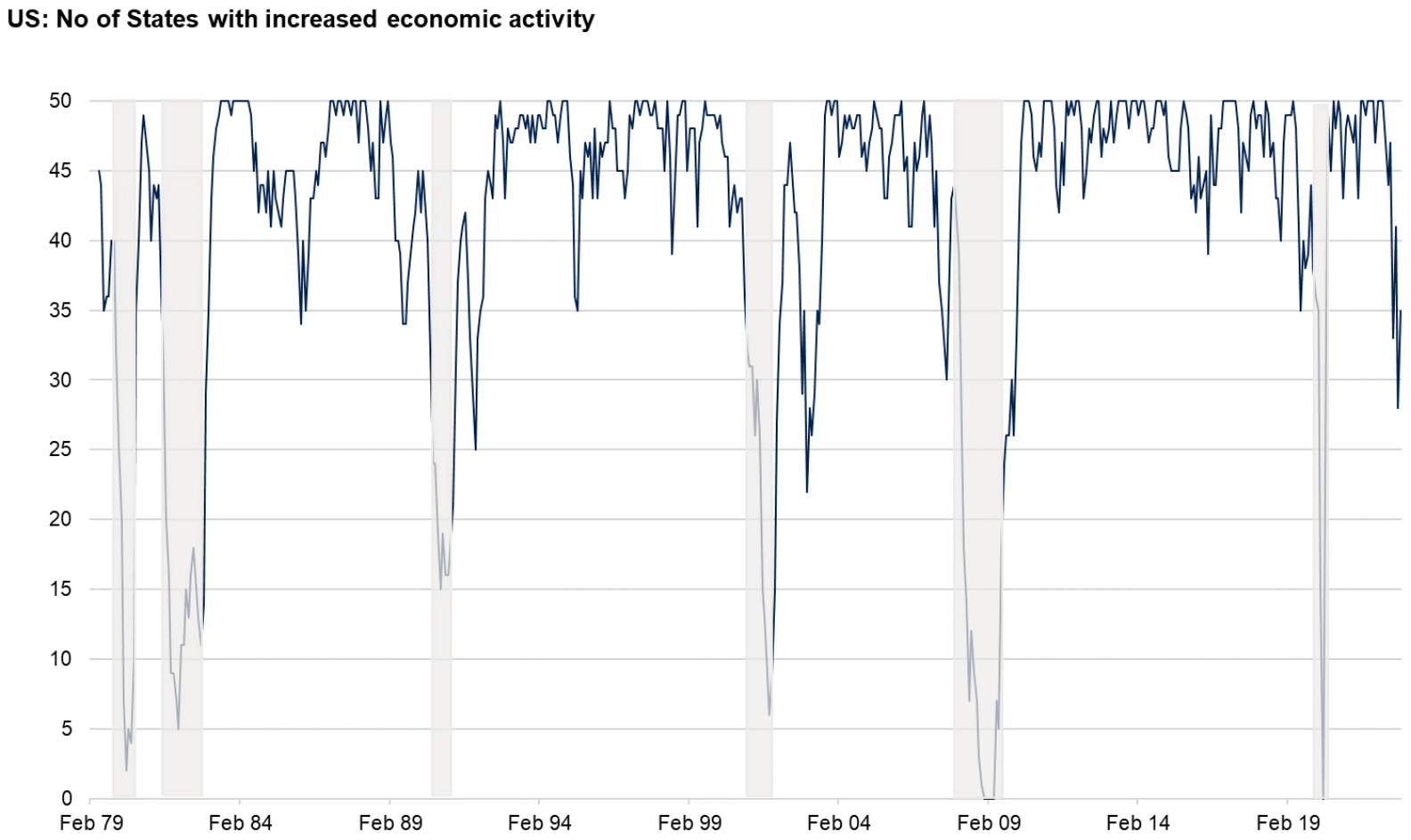
Housing construction share of GDP



Source: ABG Sundal Collier, Macrobond

Source: Macrobond, ABG Sundal Collier

US: ~30% of US States with lower economic activity

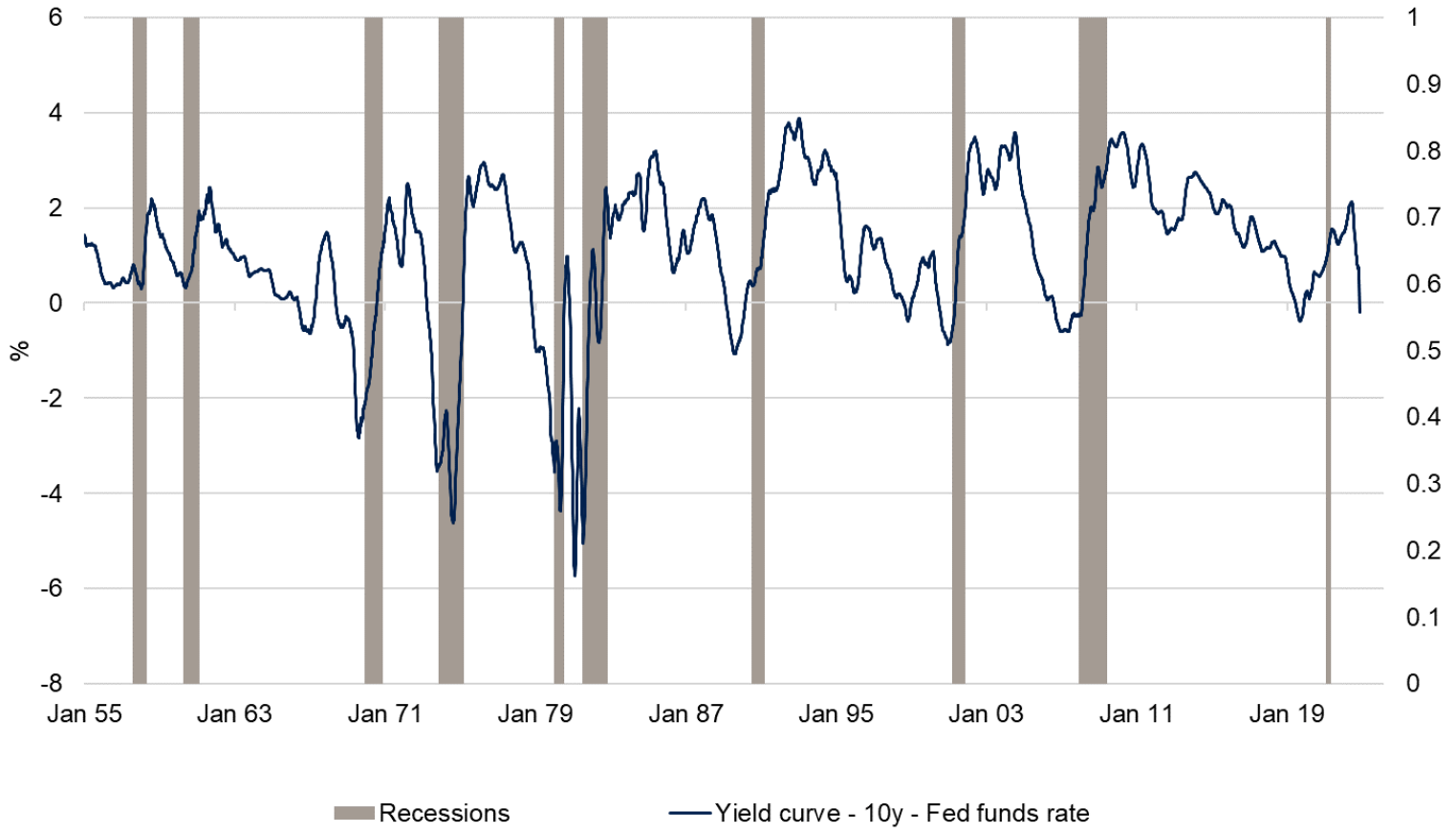


Source: Macrobond, ABG Sundal Collier

Source: Macrobond, ABG Sundal Collier

Central banks and Yield curve

US: Yield curve and recessions

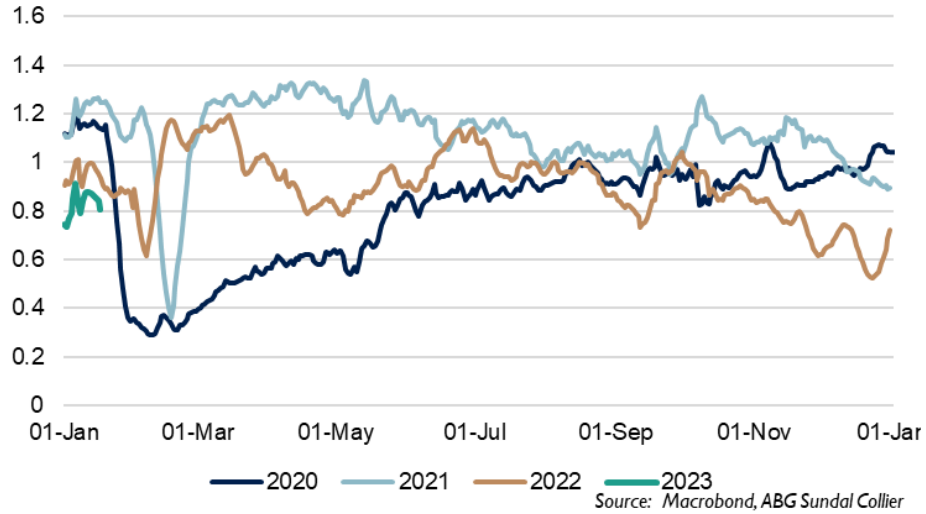


Source: ABG Sundal collier

Source: Macrobond, ABG Sundal Collier

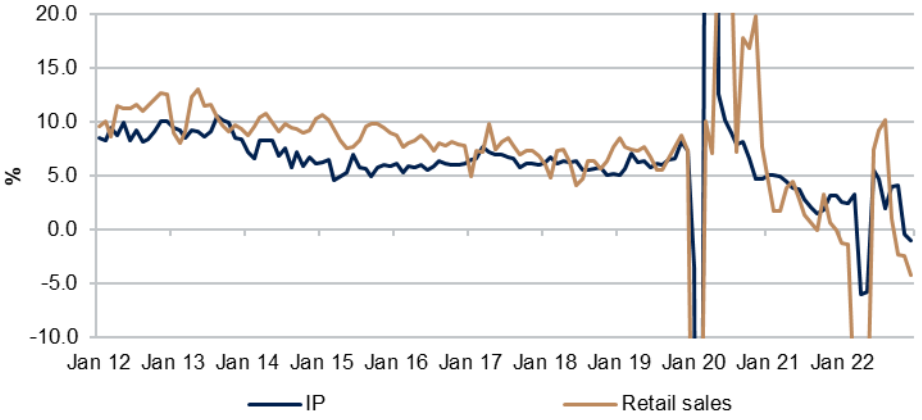
China: Major tailwind expected after peak infection

YiCai Global High Frequency Economic Activity Index



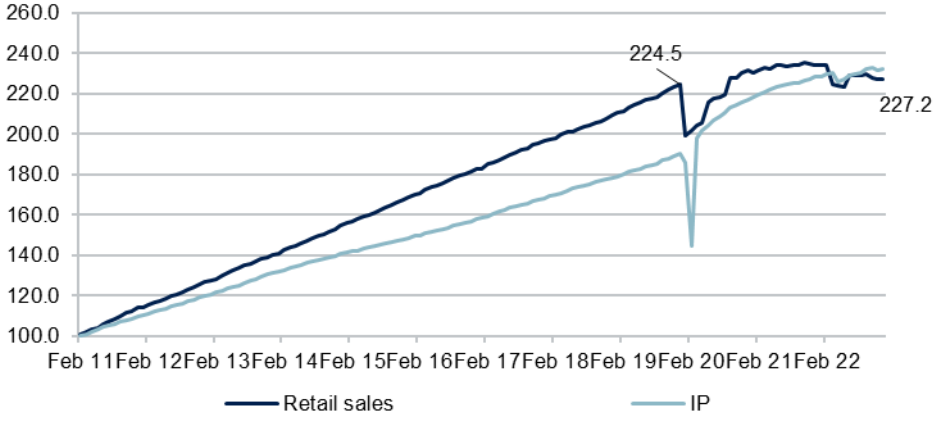
Source: Macrobond, ABG Sundal Collier

China: IP Retail Sales from M/M 3m AR, SA



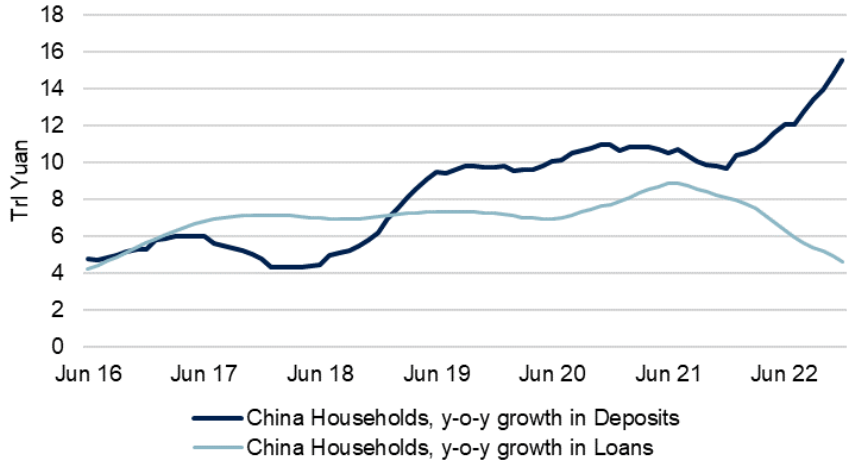
Source: ABG Sundal Collier

China: IP Retail sales, SA index



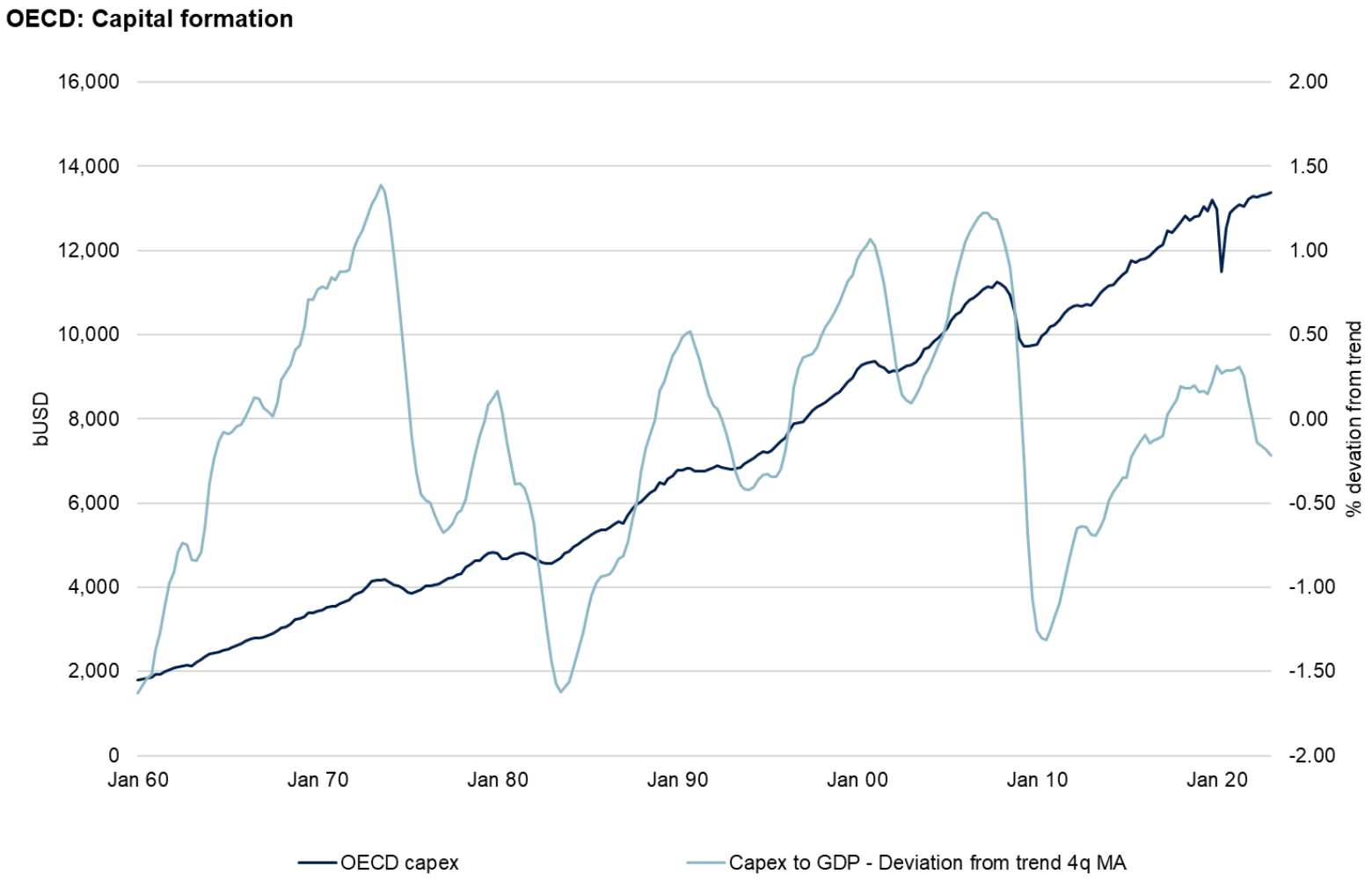
Source: ABG Sundal Collier

China: Households incrased savings - pent up demand



Source: Macrobond, ABG Sundal Collier

OECD capital expenditure



Source: Macrobond, ABG Sundal Collier

Central banks withdrawing liquidity

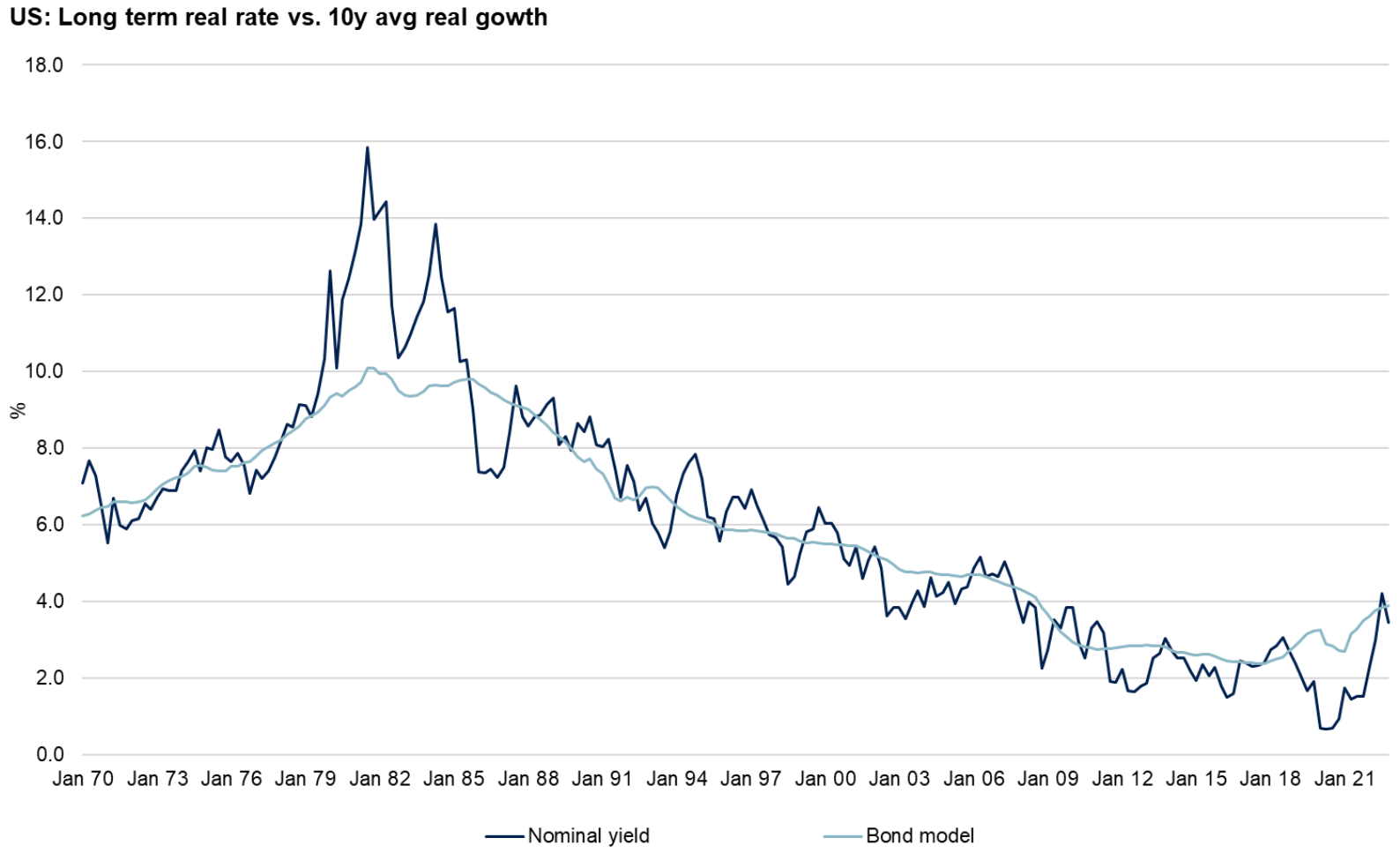
Central banks liquidity injection as share of GDP



Source: Macrobond, ABGSC

Source: Macrobond, ABG Sundal Collier

Bond model vs. actual 10y nominal yield



Source: NBER, ABG Sundal Collier

Real rates soaring – close to peak?

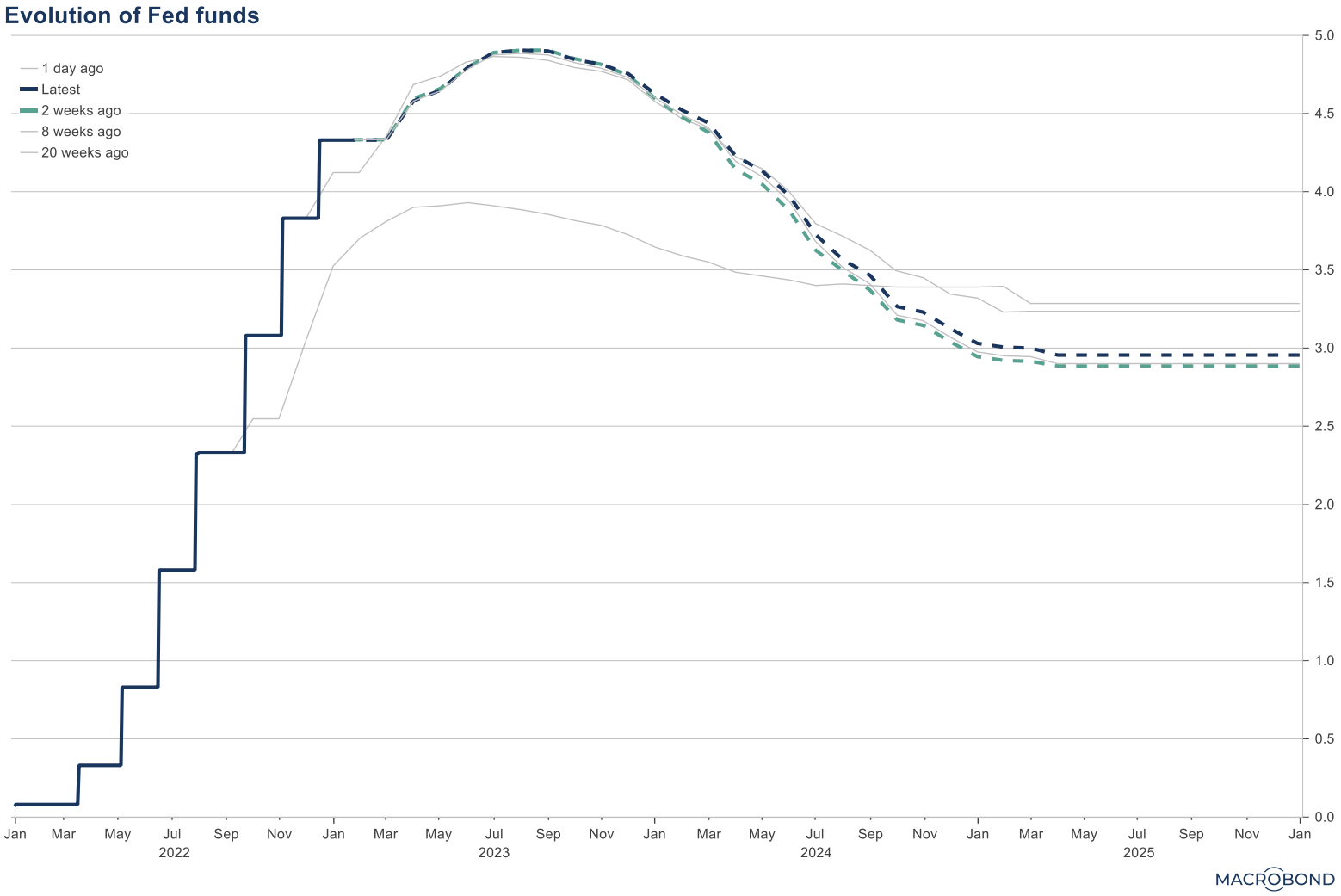


Source: NBER, ABG Sundal Collier

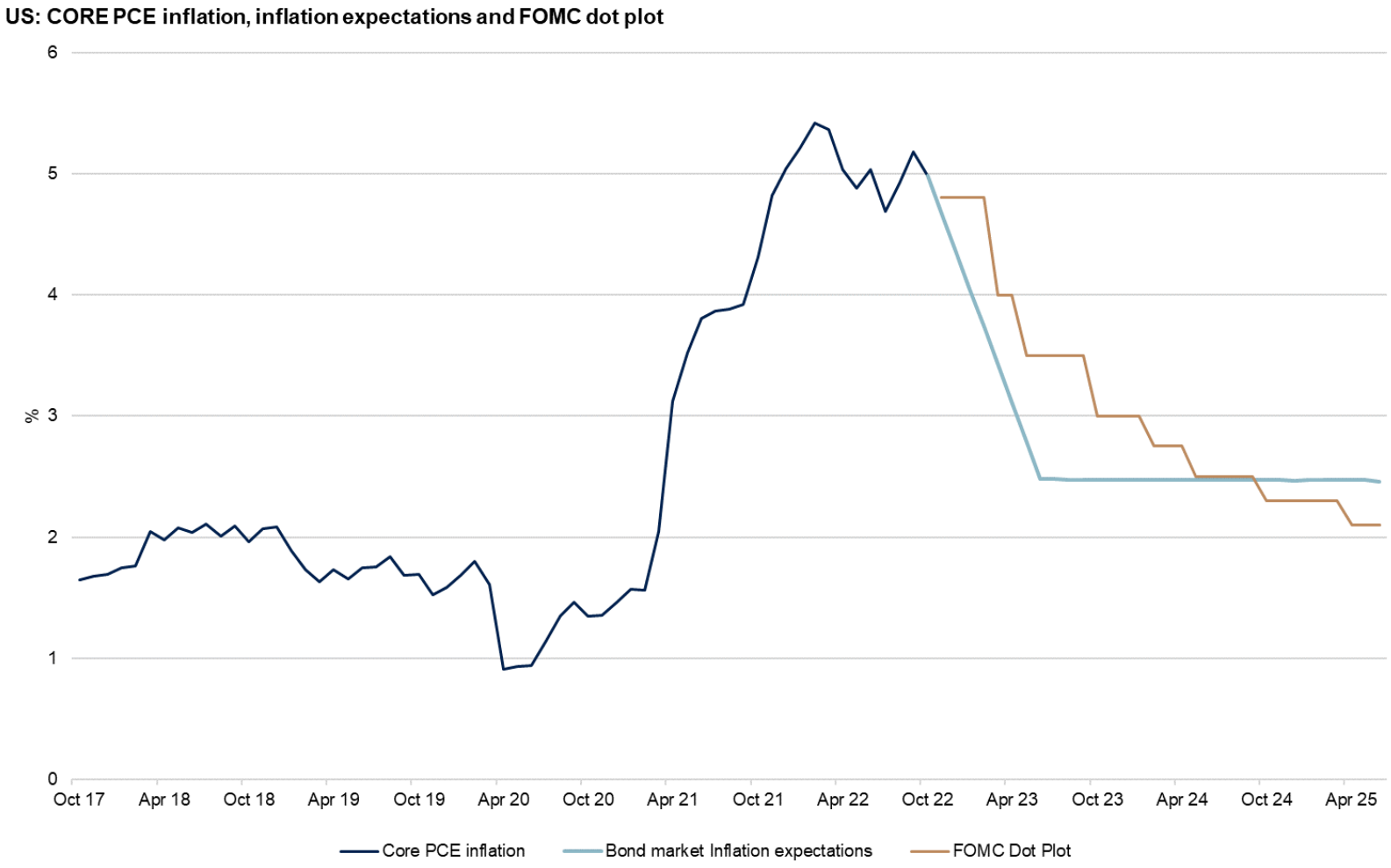
What did Powell Say?

- Price stability is the essence of a functioning economy and the Federal Reserve is responsible for a functioning economy.
- The aim is to get inflation down to 2%.
- Without price stability, you will not be able to have a strong labour market. I.e. the Federal Reserve will accept, and finds it necessary, to weaken the labour market in order to bring inflation down.
- The Federal Reserve will use its tools to ensure a better balance between supply and demand. I.e. The Federal Reserve will continue to tighten until the target is reached.
- This could result in a period of below-trend growth.
- The alternative of not reducing inflation is significantly worse.
- If businesses and households expect prices to rise quickly for a long time, it will be more difficult to bring inflation down (which is the goal).

Market is more dovish than Fed (FOMC dot plot peak at 5.25%)

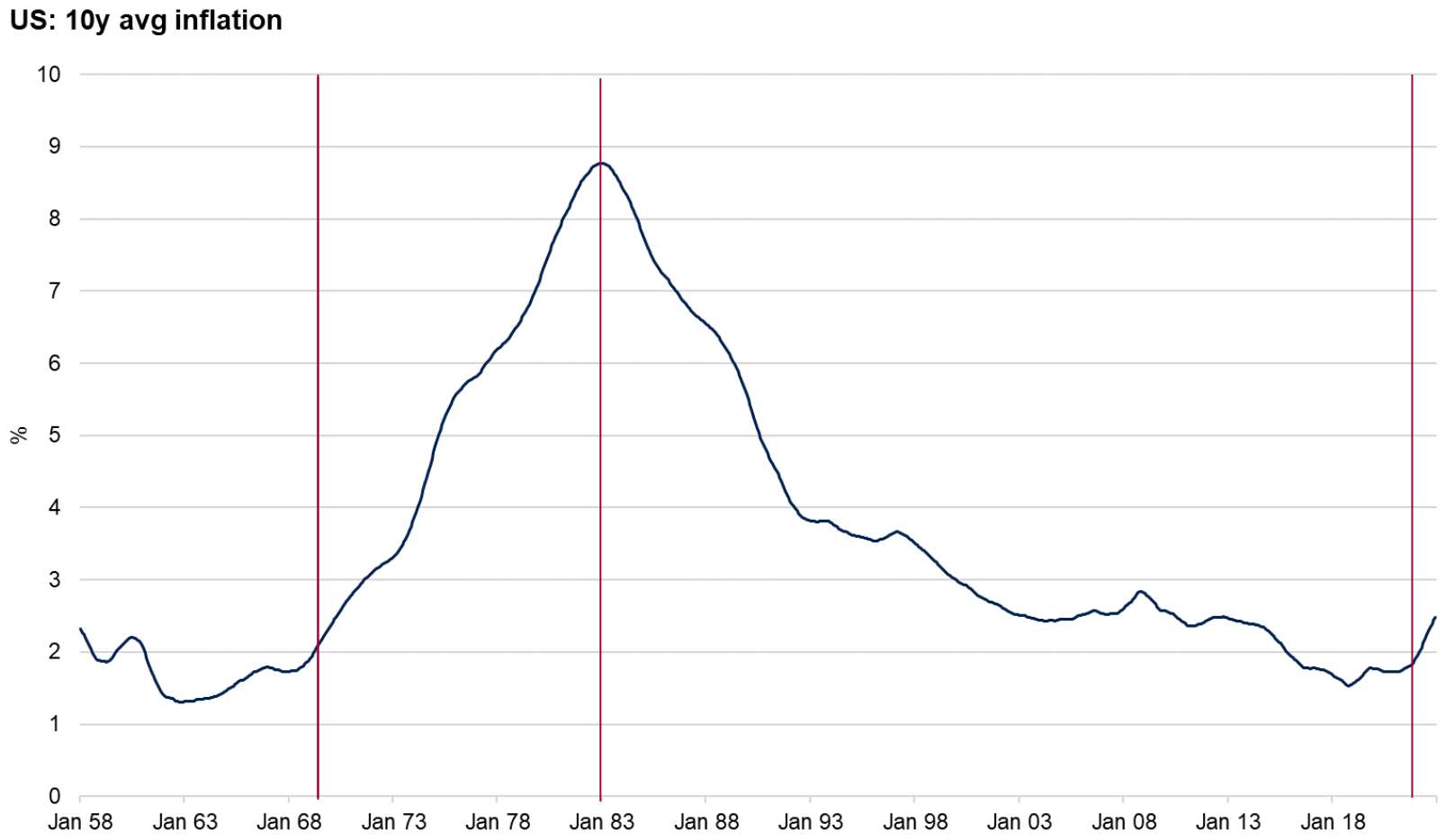


Market is more optimistic about inflation than FED



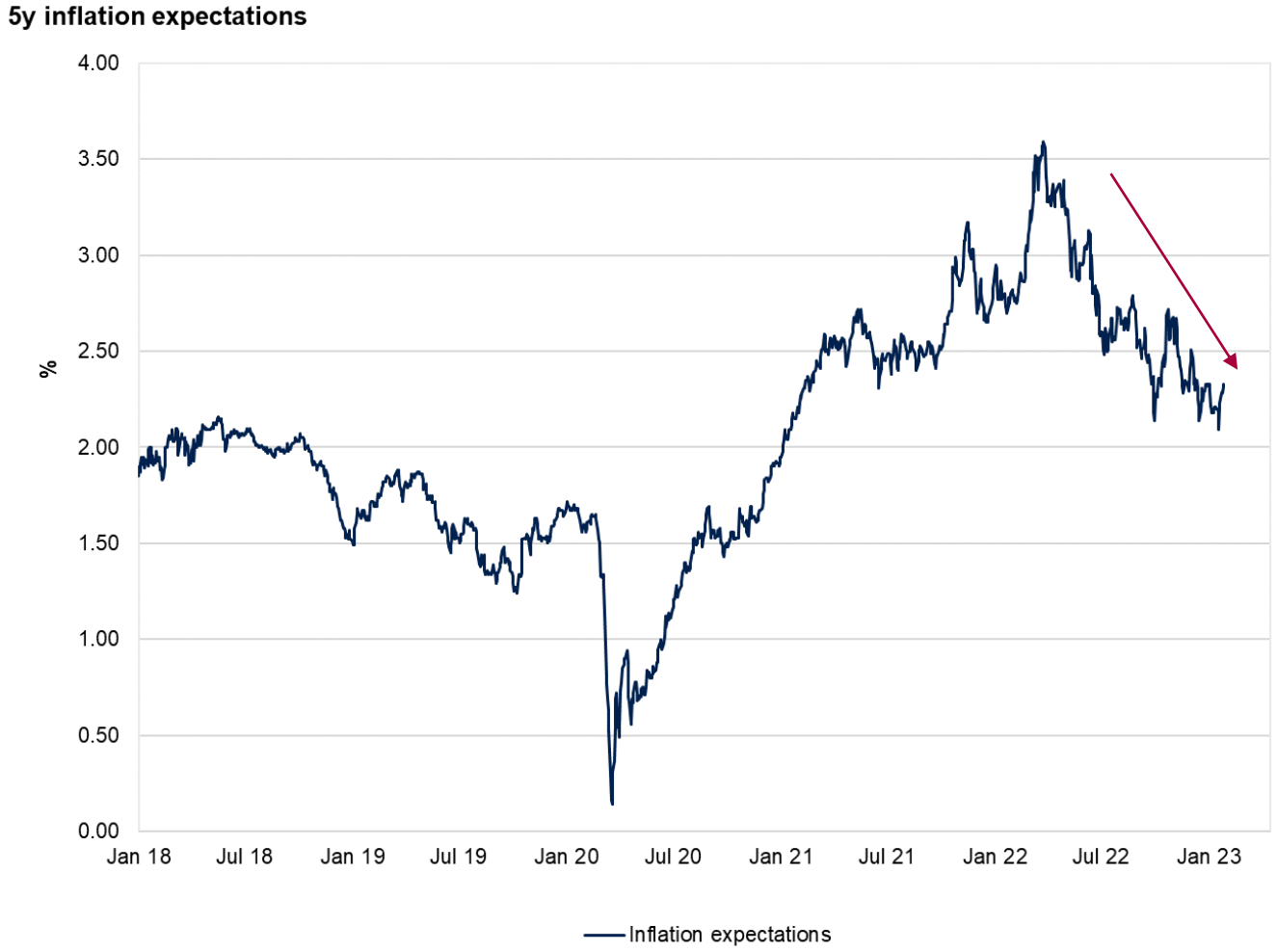
Source: Macrobond, Federal Reserve, ABGSC

Inflation: Are we in 1969?



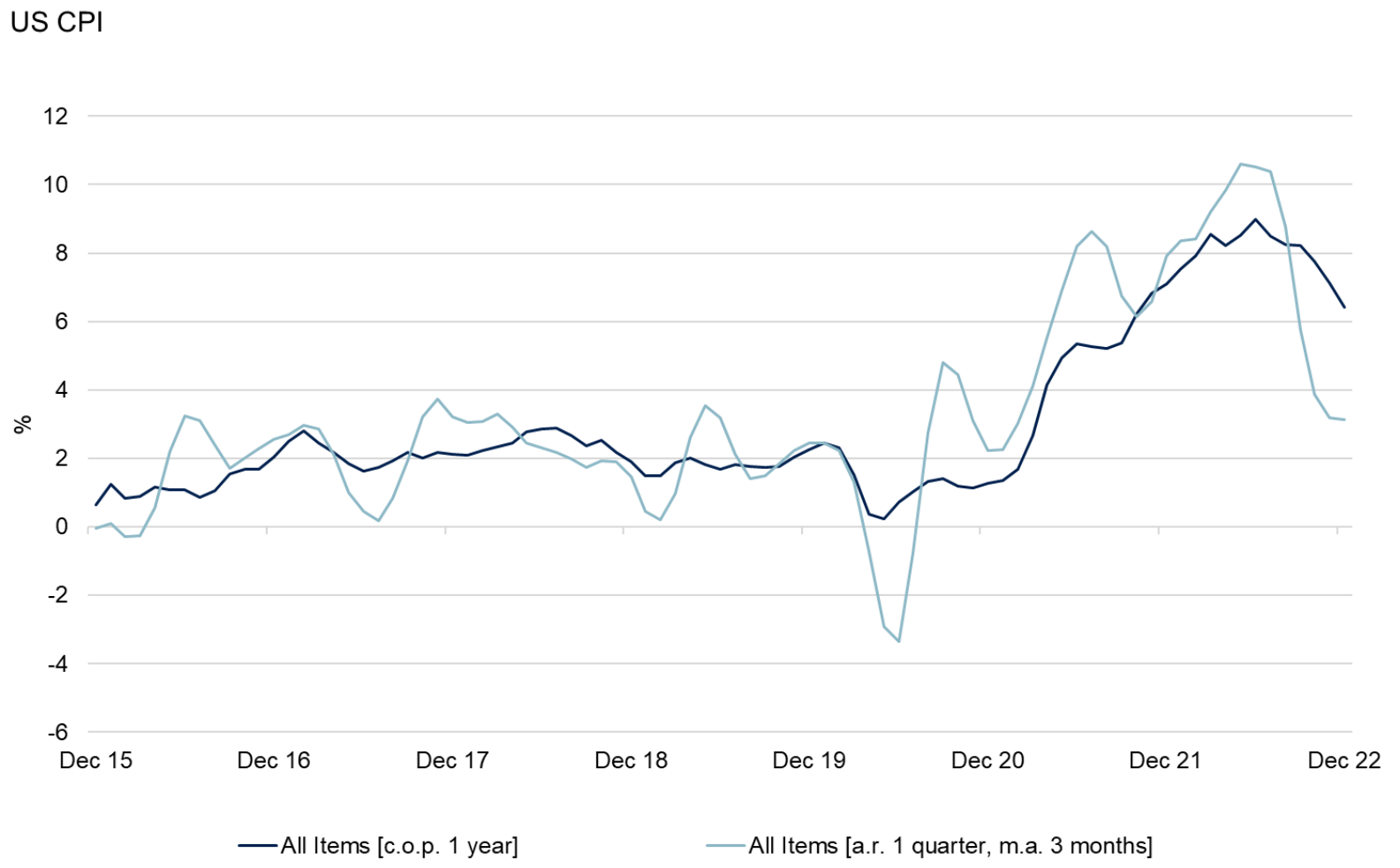
Source: ABG Sundal Collier

Inflation expectations plummeting



Source: Macrobond, ABGSC

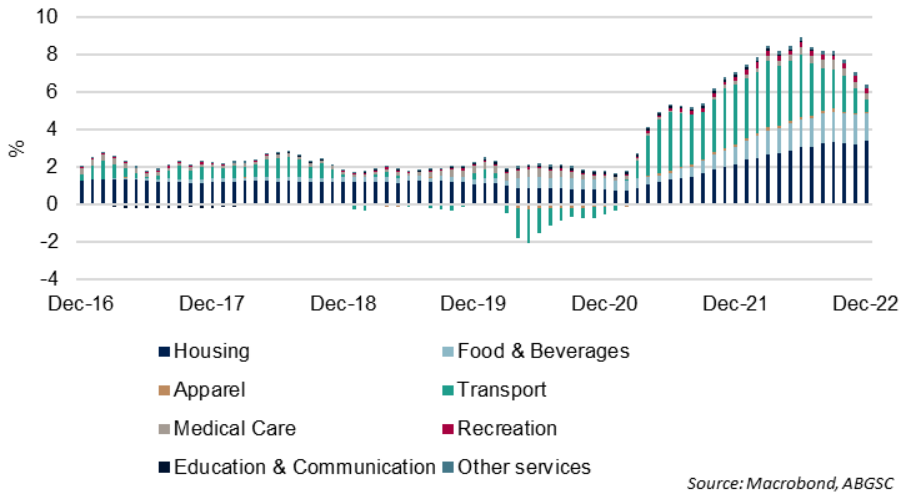
CPI – annual growth last 3m ~ 3%



Source: Macrobond, ABGSC

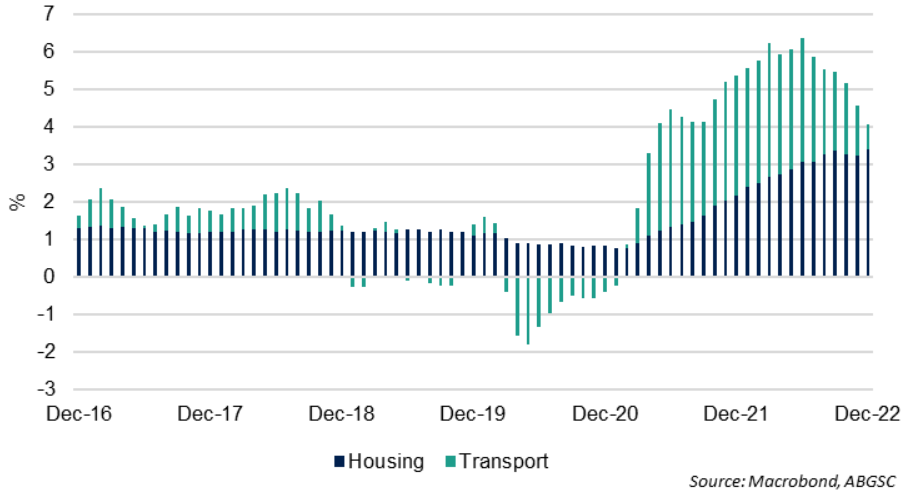
Inflation: two key drivers rolling off

US: Contribution to Inflation



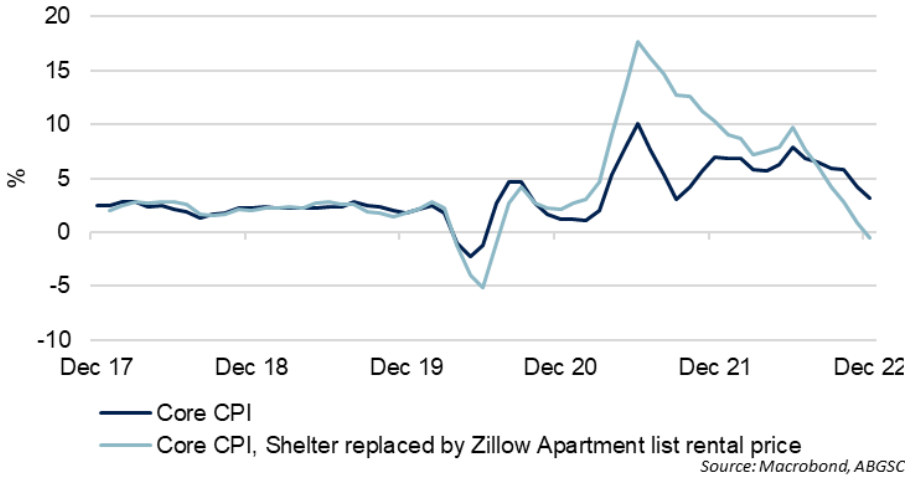
Source: Macrobond, ABGSC

US: Contribution to Inflation



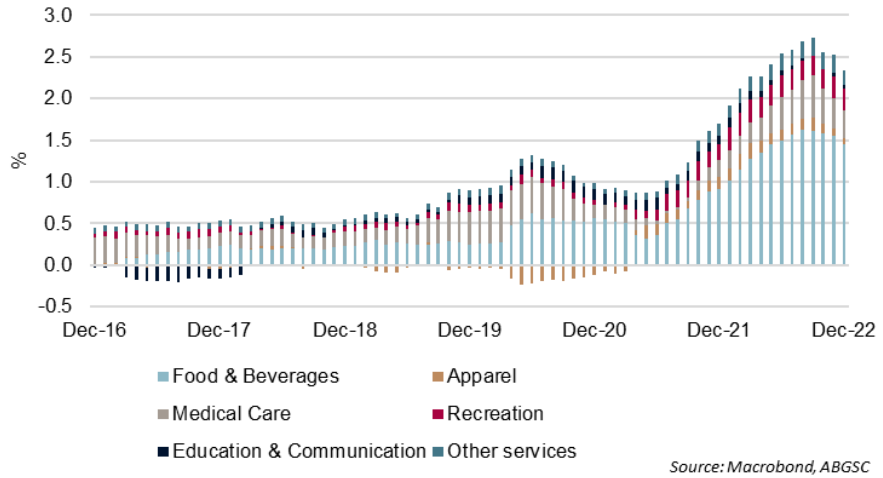
Source: Macrobond, ABGSC

US CPI



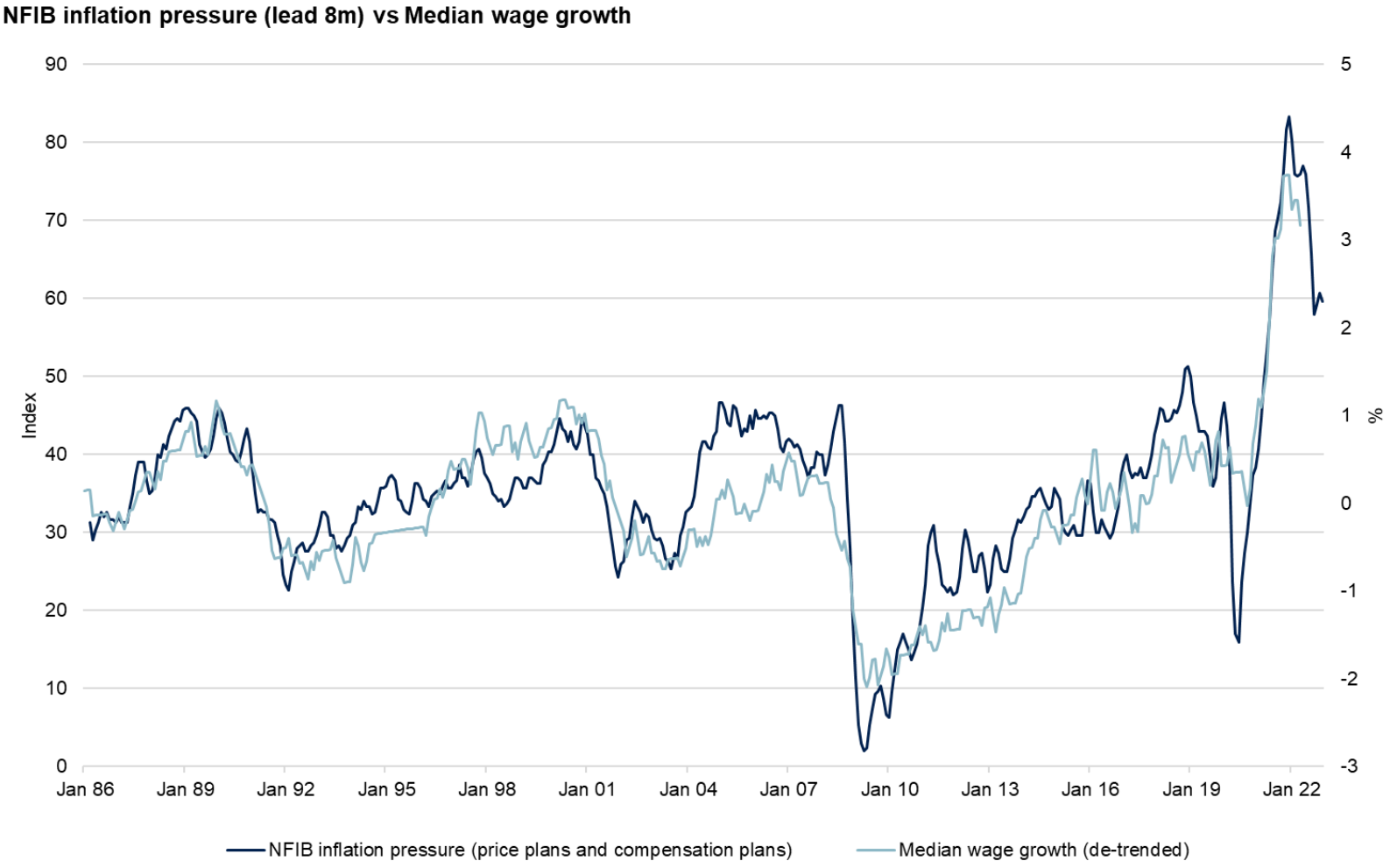
Source: Macrobond, ABGSC

US: Contribution to Inflation ex transport, housing



Source: Macrobond, ABGSC

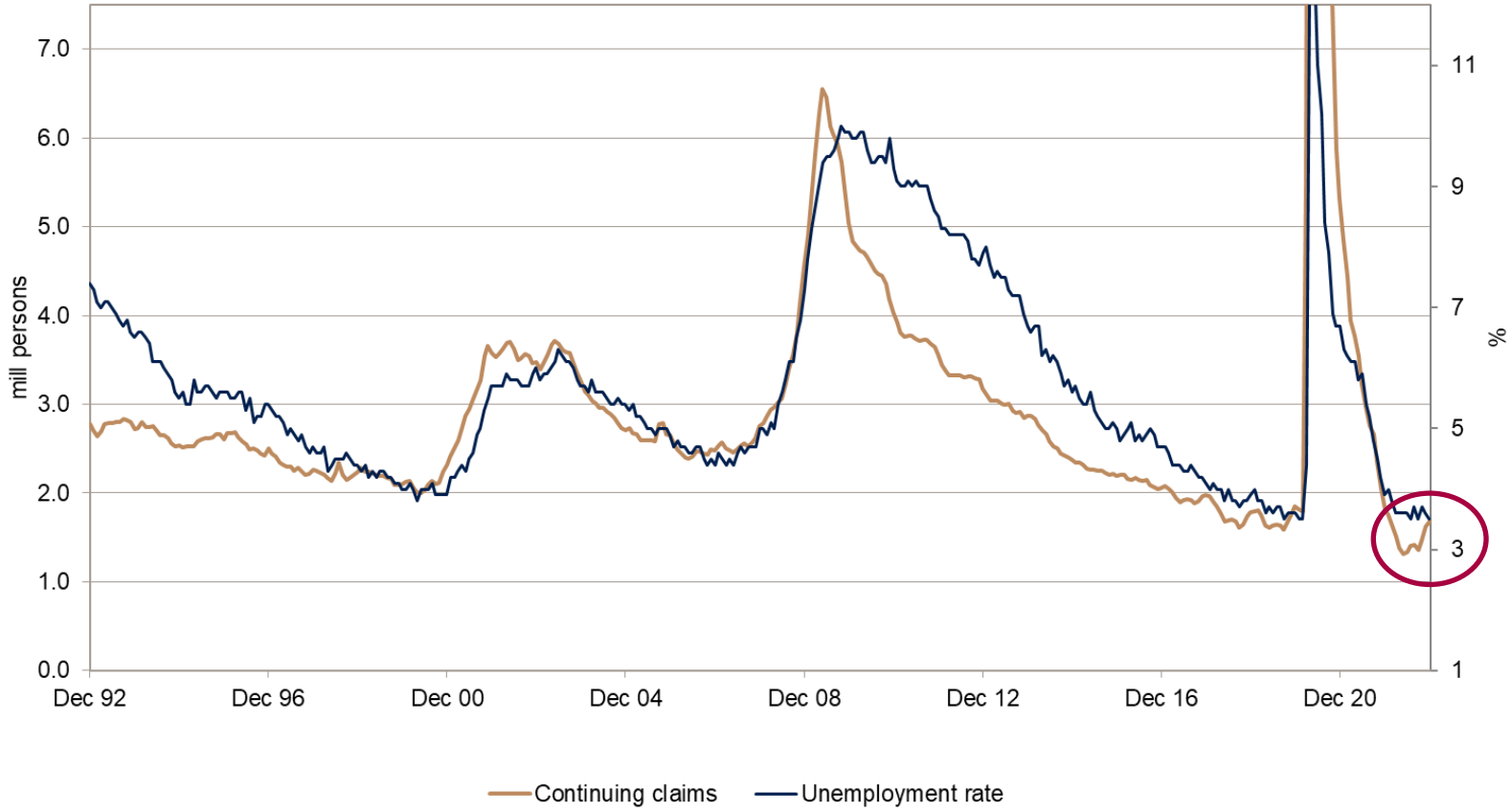
Companies say less wage, price pressure, wage growth to follow



Sourcee: ABG Sundal Collier

Continuing claims started to point up

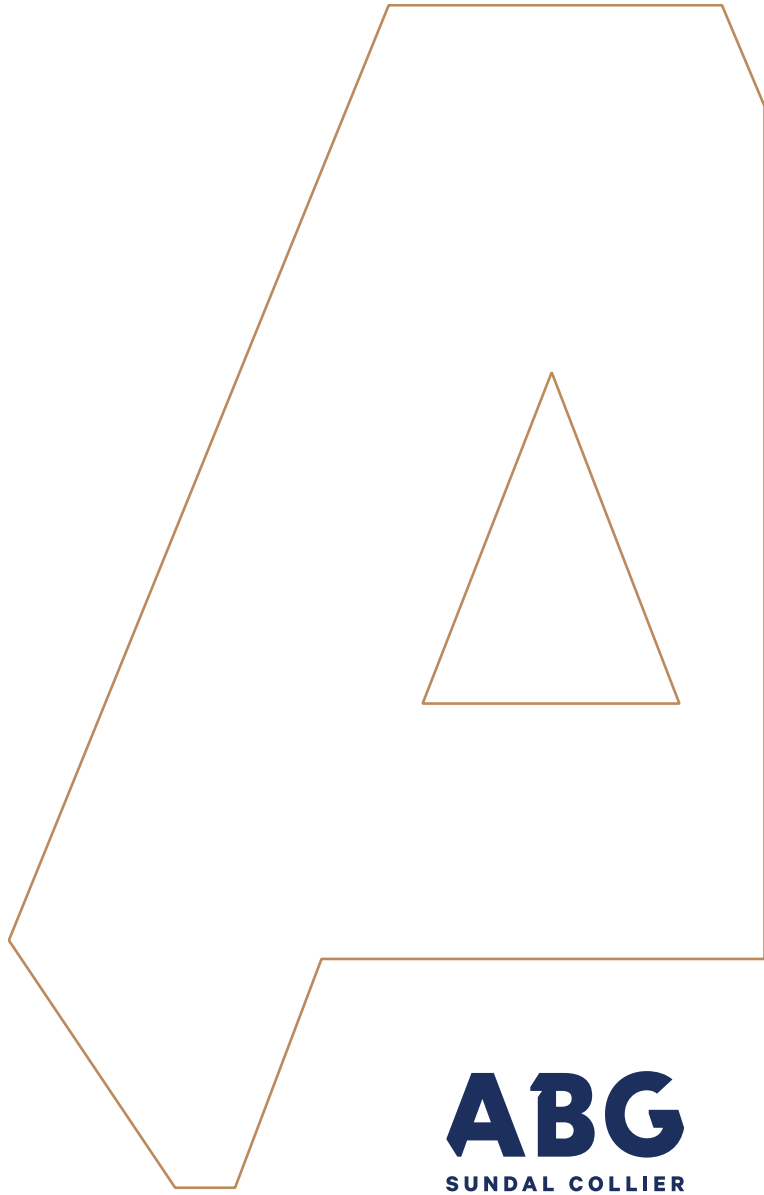
Continuing Claims vs. Unemployment Rate



Source: ABG Sundal Collier

Stock market

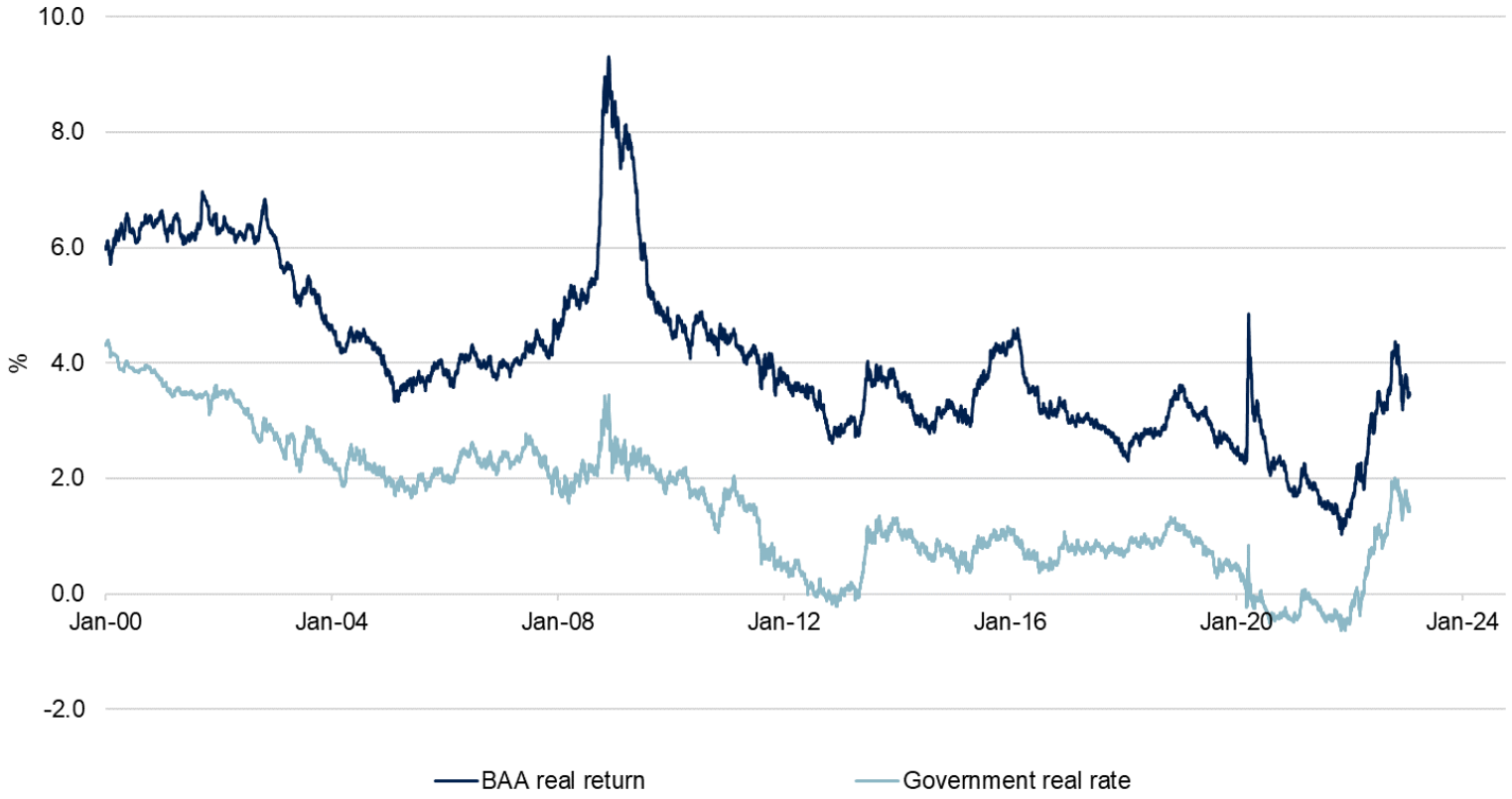
Earnings, valuation and style/sectors



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US: Tough comps: ~3.5% Real return in BAA bonds

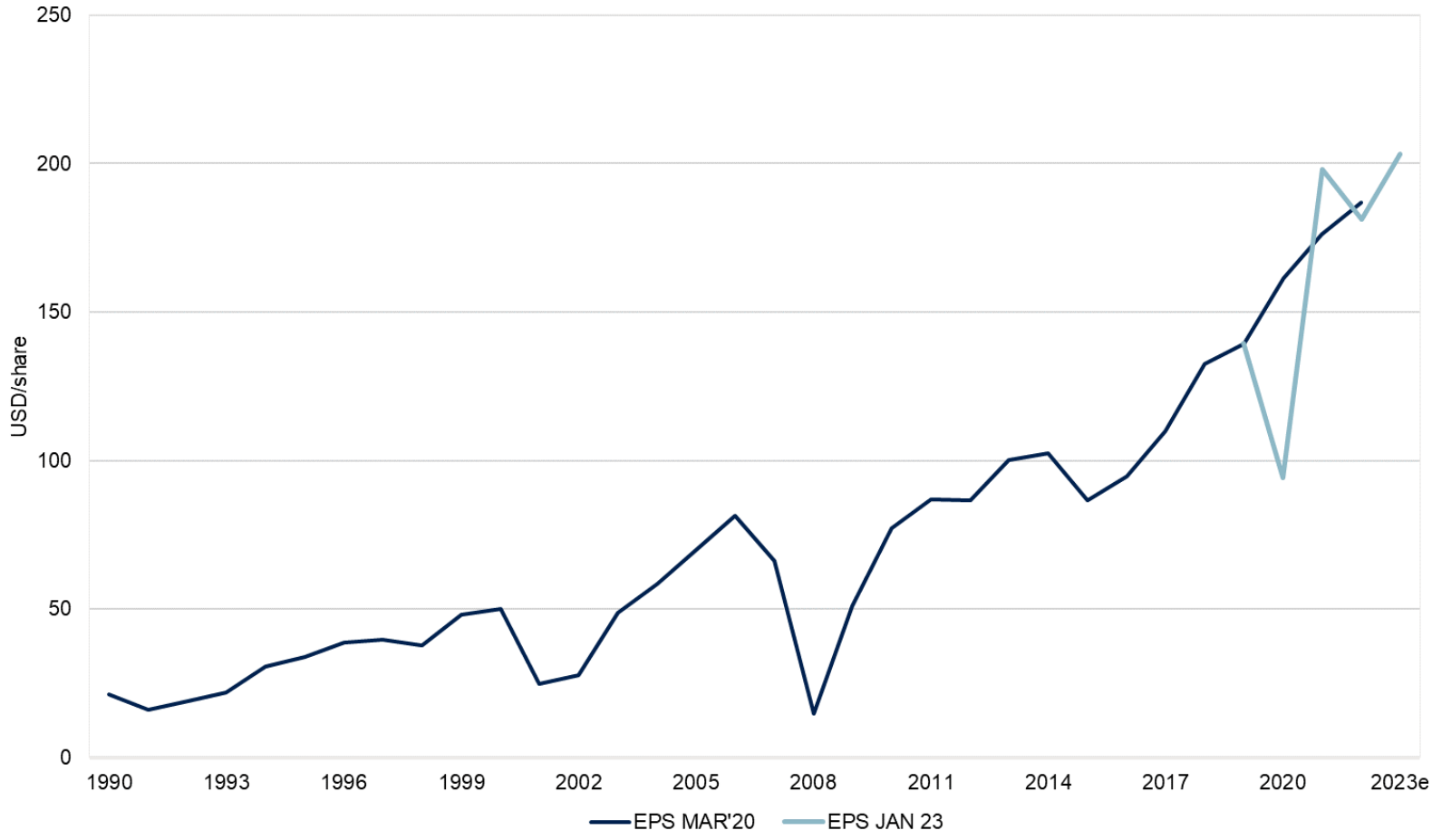
US: Corporate Bond real return



Source: Macrobond, ABGSC

US: S&P 500: Earnings down 9% in 22e and up 12% in 23e

S&P 500: EPS and forecasted EPS 2020-2022e



Source: Factset, S&P, ABG Sundal Collier

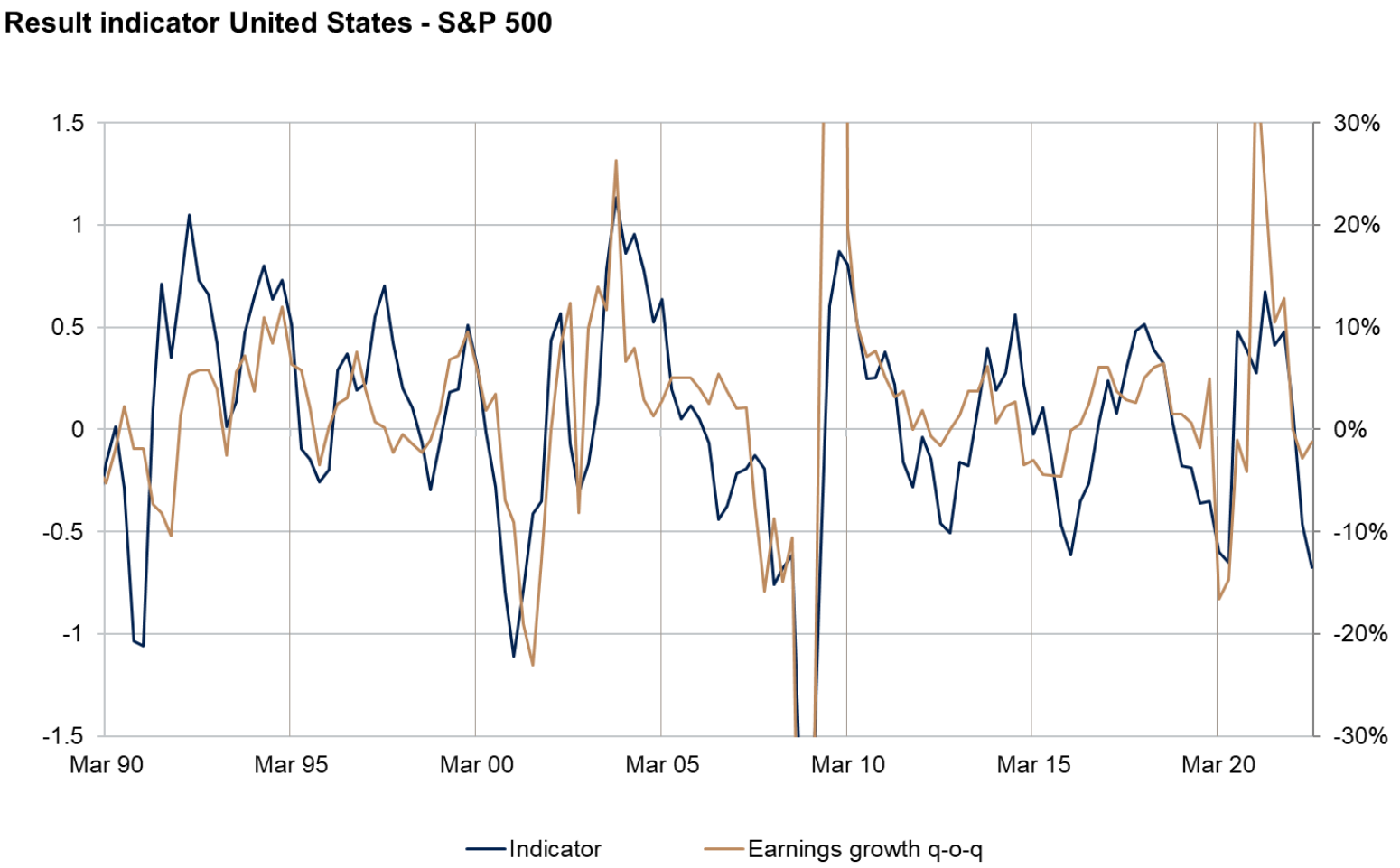
ISM vs. Earnings



Source: ABG Sundal Collier

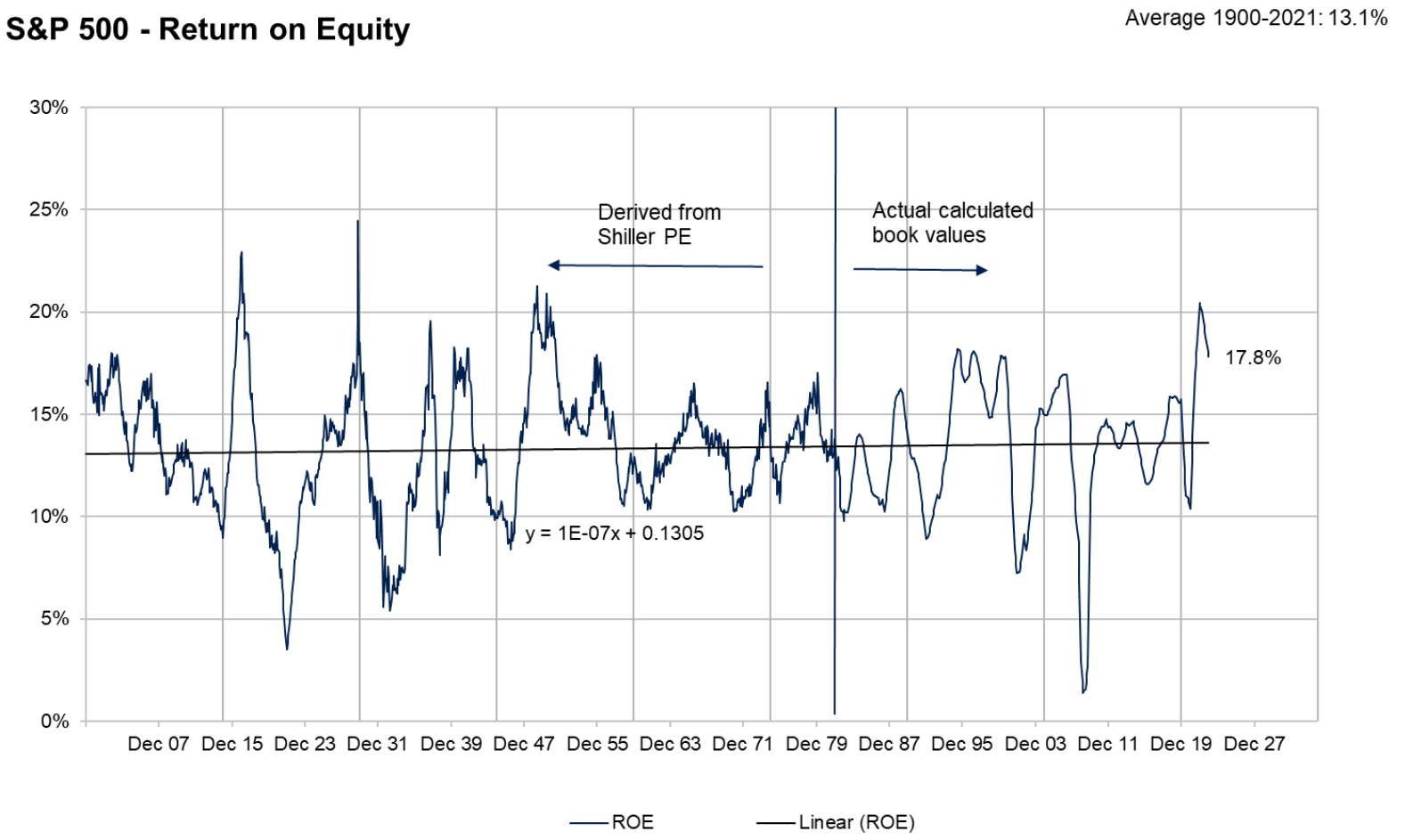
Source: Macrobond, ABG Sundal Collier

Result indicator vs. earnings



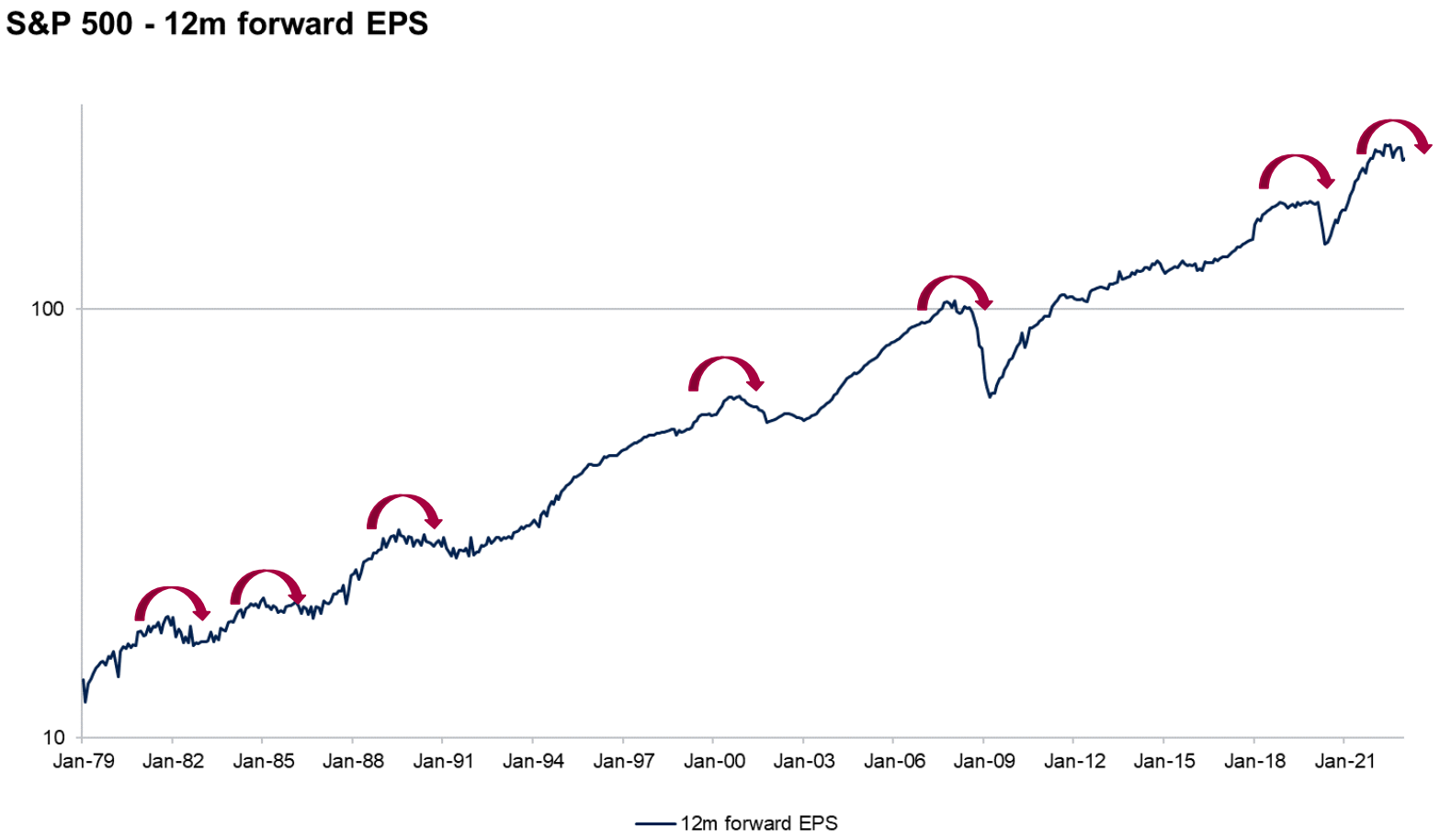
Source: Macrobond, ABG Sundal Collier

US: S&P 500



Source: Robert Shiller, IBES, Bloomberg, S&P, ABG Sundal Collier

S&P 500 – 12m forward EPS – ~Down 4% from Peak



Source: Macrobond, Standard&Poors, Factset, ABG Sundal Collier

Source: S&P, ABG Sundal Collier

US: 12m forward EPS

12m forward EPS	Peak	Bottom	Change	Change to next peak	Years to next peak
1981	19	16	-15%		
1985	20	19	-6%	25%	4
1989	30	26	-11%	56%	4
2000	62	54	-13%	137%	11
2008	103	62	-40%	89%	8
2020	175	142	-19%	182%	12
2023e	240	199	-17%	69%	3
2031e	393			98%	
Avg			**-17%**	**98%**	**8**
Median			**-14%**	**89%**	**8**

Source: Macrobond, ABG Sundal Collier

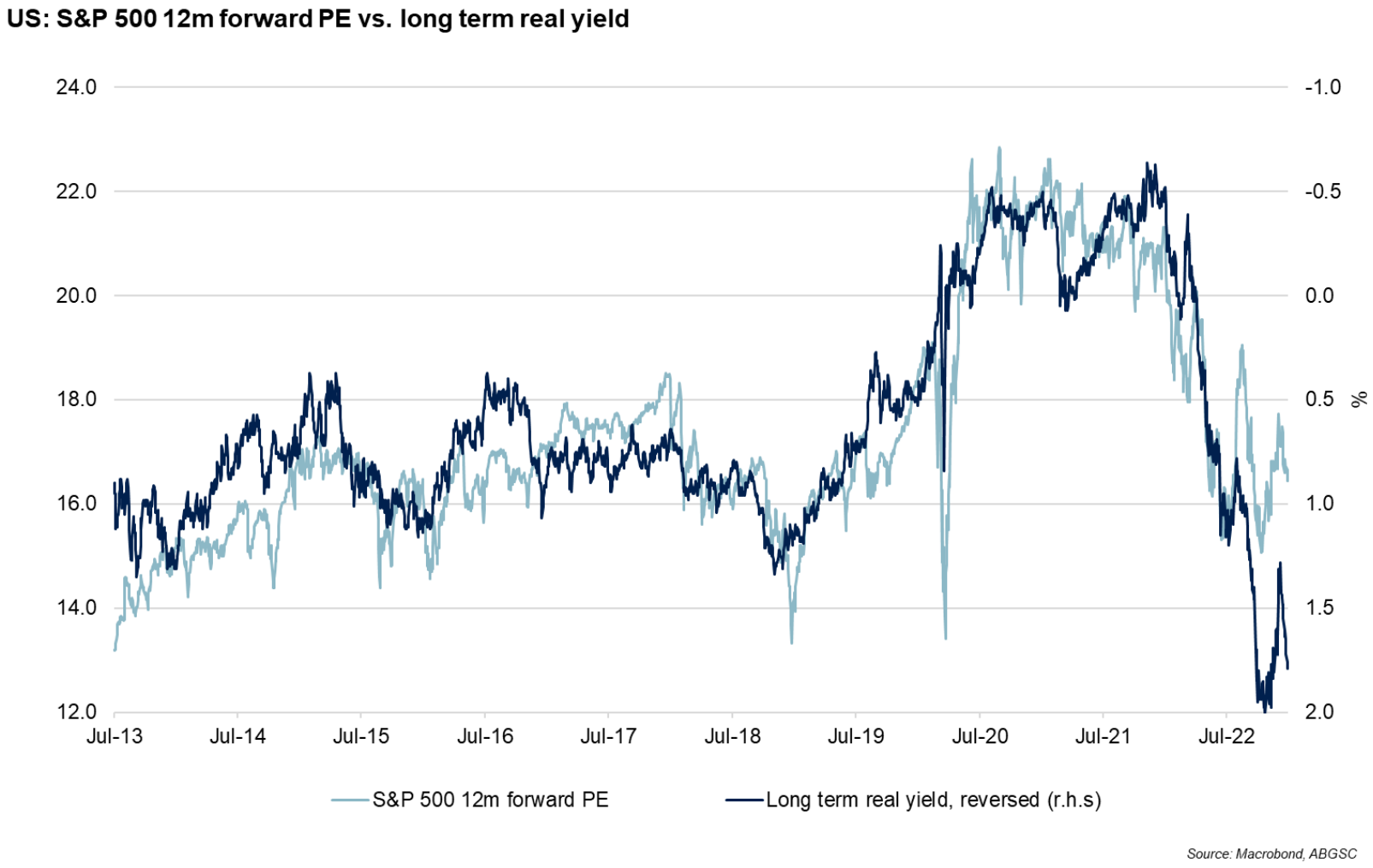
US: interest rates when Fed cuts

Recession	Policy rate Peak (%)	Policy rate Through (%)	Change in policy rate (%)	% change in policy rate
Apr 1960-Feb 1961	4.00	0.25	-3.75	-94%
Dec 1969-Nov 1970	9.75	3.00	-6.75	-69%
Nov 1973-Mar 1975	13.00	4.75	-8.25	-63%
Jan 1980-Jul 1980	20.00	9.00	-11.00	-55%
Jul 1981 - Nov 1982	20.00	8.50	-11.50	-58%
Jul 1990 - Mar 1991	9.75	3.00	-6.75	-69%
Mar 2001 - Nov 2001	6.50	1.00	-5.50	-85%
Sep 2007 - Jan 2009	5.25	0.25	-5.00	-95%
Feb 2020 - April 2020	2.50	0.25	-2.25	-90%
H1'23	5.00			
Average			**-6.75**	**-75%**
Median			**-6.75**	**-69%**

Recession	10y interest rate start	10y interest rate End	Change in 10y interest rate
Apr 1960-Feb 1961			0.00
Dec 1969-Nov 1970	7.60	6.90	-0.70
Nov 1973-Mar 1975	6.70	7.15	0.45
Jan 1980-Jul 1980	10.50	10.00	-0.50
Jul 1981 - Nov 1982	14.00	10.40	-3.60
Jul 1990 - Mar 1991	8.25	7.75	-0.50
Mar 2001 - Nov 2001	4.75	4.25	-0.50
Sep 2007 - Jan 2009	4.00	3.10	-0.90
Feb 2020 - Apri 2020	1.50	0.60	-0.90
Average			**-0.79**
Median			**-0.50**

Source: Macrobond, ABG Sundal Collier

US: 12m forward P/E vs real rate 2013-2022



Source: Macrobond, ABGSC

US: 12m forward PE and fair Value

Theoretical P/E formula

$$P/E = \frac{ROE - g}{ROE \times (COE - g)}$$

Source: ABG Sundal Collier

	Index	12m forward EPS	12m forward PE
Peak	4,766	240	19.9
Today	4,071	228	17.9
Fair 12m Forward PE and Value	4,118		18.1

- Recession scenario 1
  - 12m forward EPS cut by 17%
  - Long term interest rates plummet to 2.5%
  - Fair PE increases to 22.5 from 17.9
  - Index up ~10%

	Index	12m forward EPS	12m forward PE
Recession	4,071	199	20.5
Fair 12m Forward PE and Value	4,463		22.5

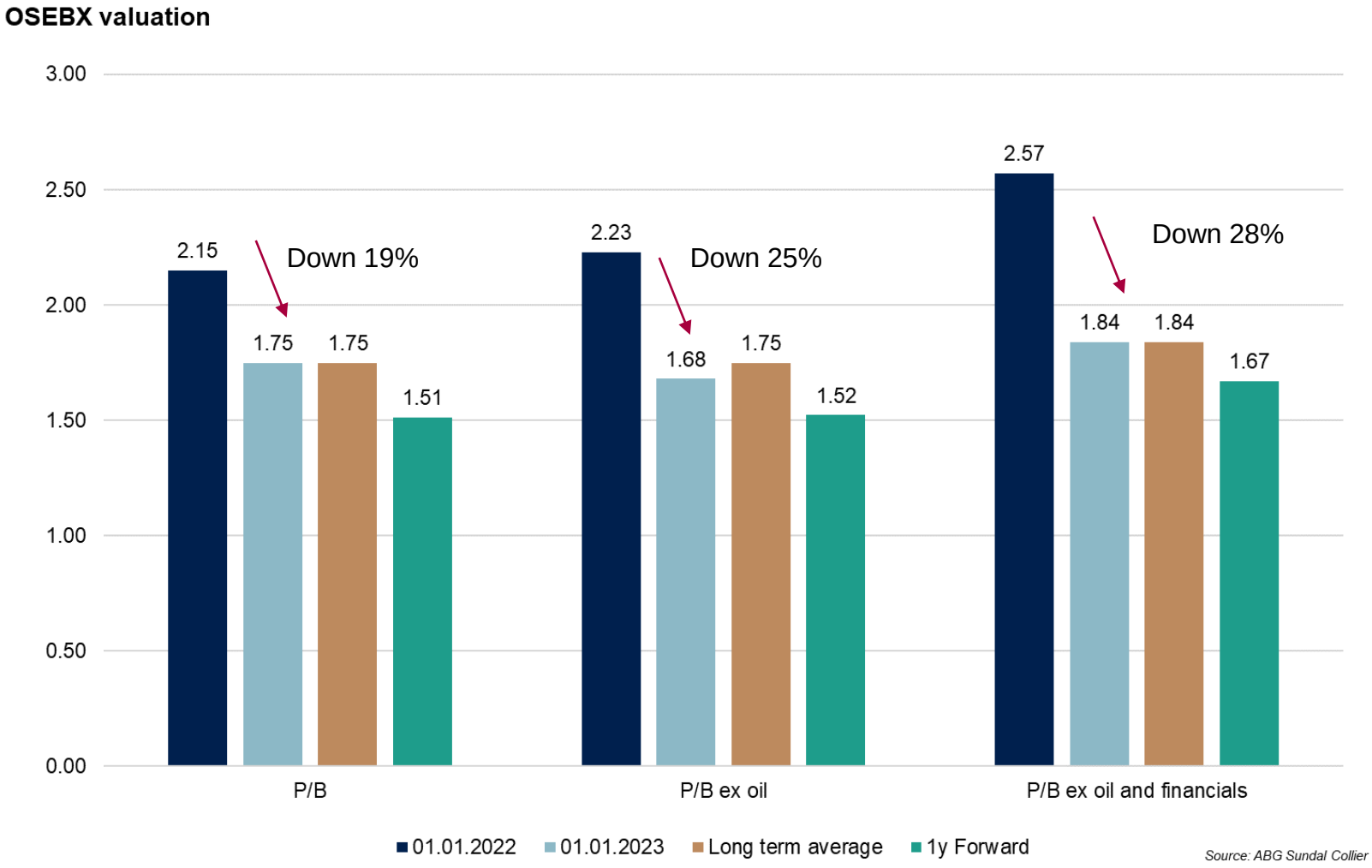
- Recession scenario 2
  - 12m forward EPS cut by 17%
  - Long term interest rates stable
  - Fair PE falls to 17.8 index down ~12%

	Index	12m forward EPS	12m forward PE
Recession	4,071	199	20.5
Fair 12m Forward PE and Value	3,570		18.0

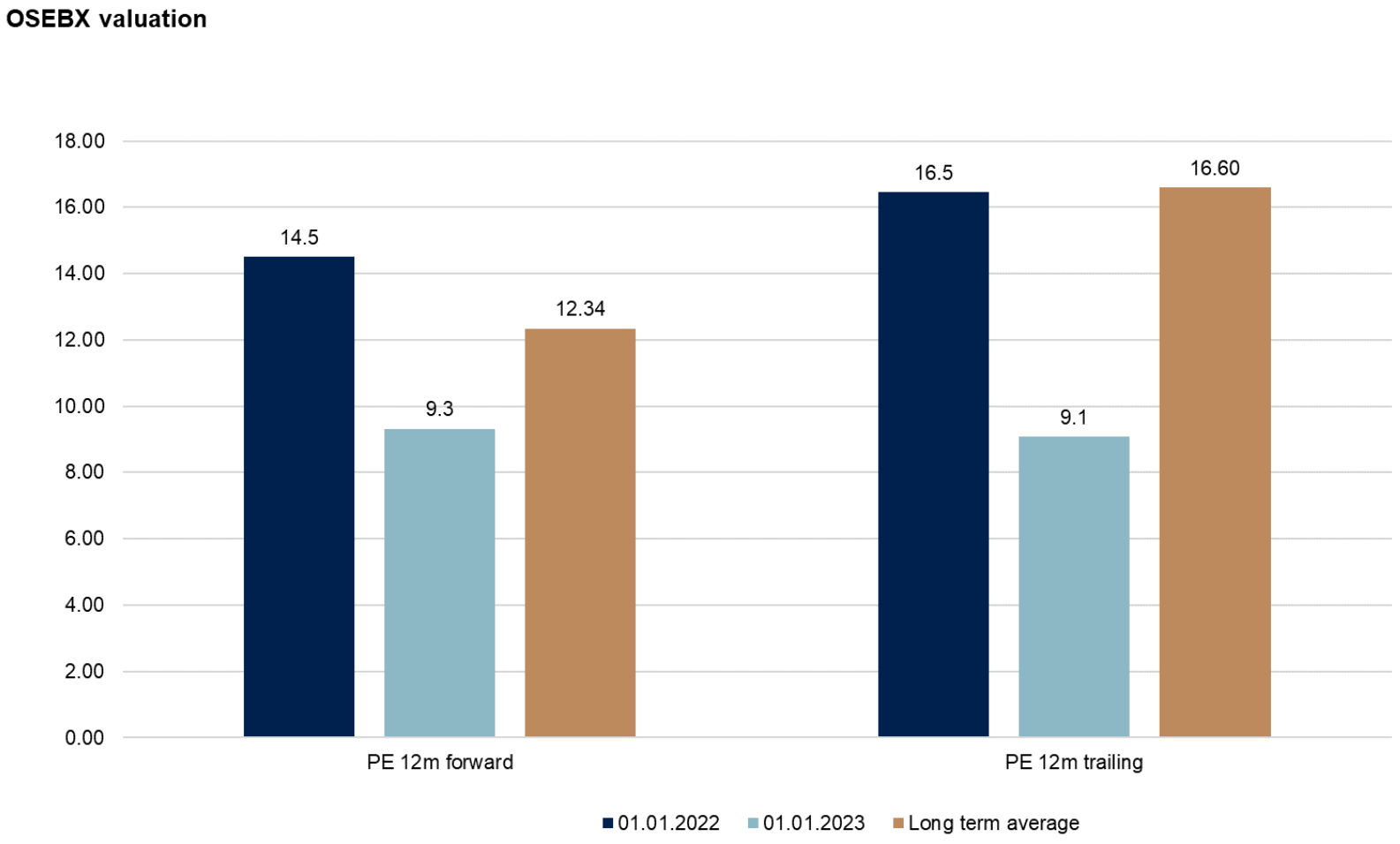
US: Scenarios

	Today	Recession	Next Bull period
Book Value S&P 500	1,002	1,002	1,250
12m forward ROE	22.8%	19.8%	31%
G	2.0%	2.0%	2.0%
10y interest rate	3.6%	2.5%	3.6%
Risk premium	3.5%	3.5%	3.5%
Cost of Equity	7.1%	6.0%	7.1%
Fair PE	18.1	22.5	18.5
12m forward EPS	228	199	393
Fair value	**4,118**	**4,463**	**7,282**
Today	**4,071**	**4,071**	**4,071**
Upside	**1%**	**10%**	**79%**

OSEBX: P/B today vs. 1 year ago



OSEBX: P/E today vs. 1 year ago.



Source: ABG Sundal Collier

Stock market HAS discounted an earnings recession!

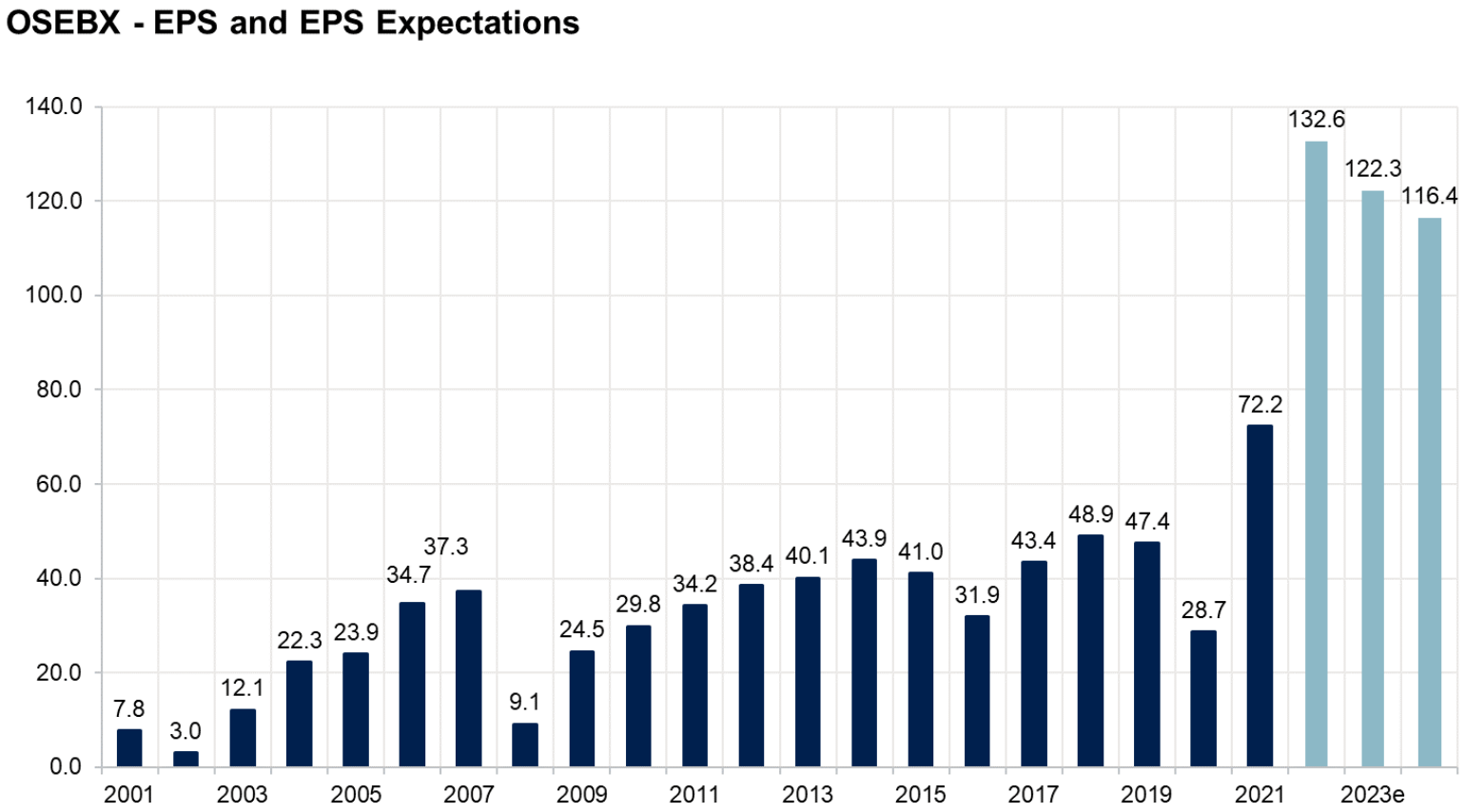
IF – Forecasted earnings

1. We assume flat markets
2. We assume 12m forward PE back to average YE 2023. 12m forward EPS must be lowered ~25%

IF – Actual earnings

1. We assume flat markets
2. We assume 12m trailing PE back to average YE 2023 actual earnings must collapse 45% in 2023

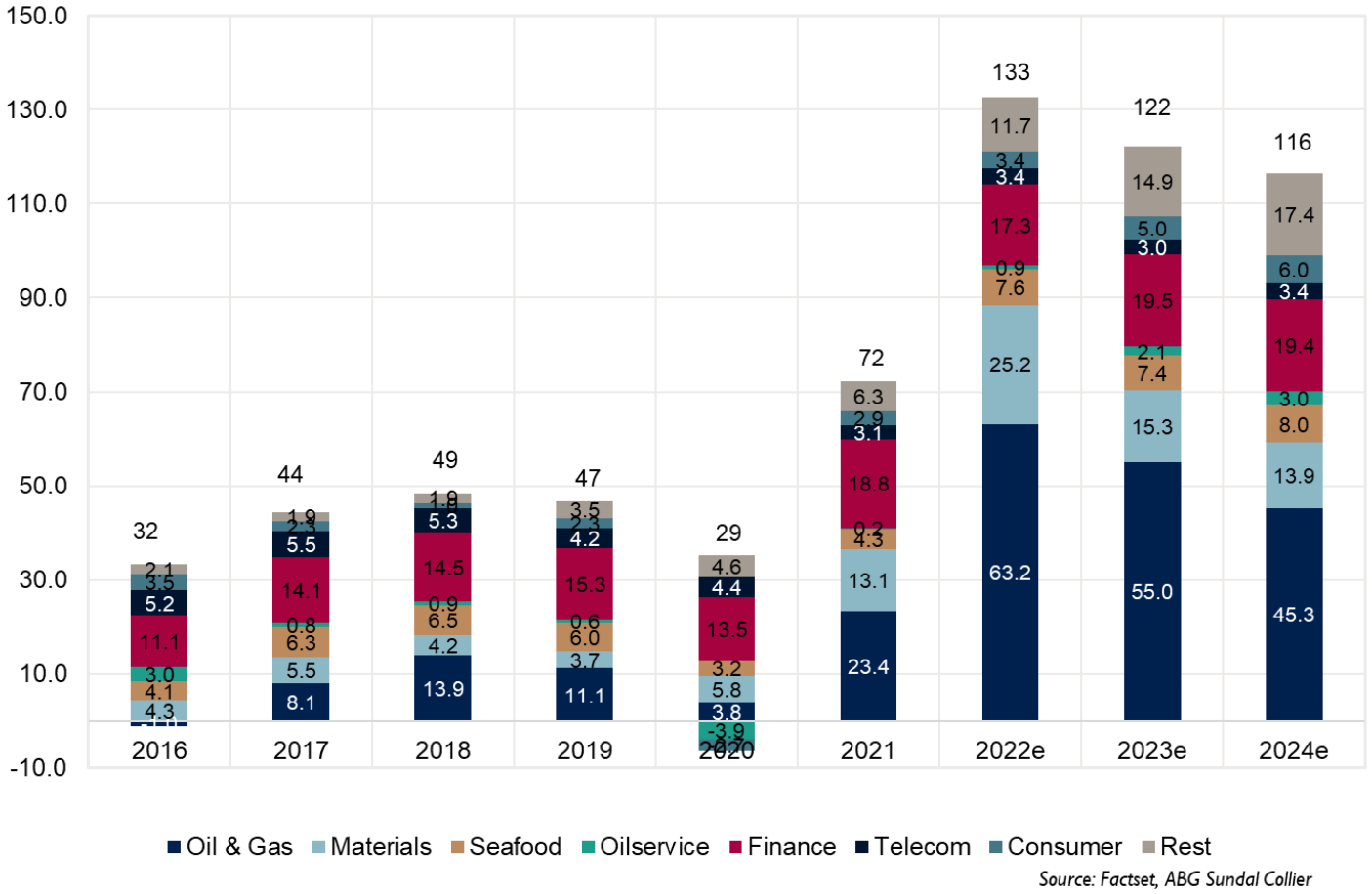
OSEBX: EPS



Source: Factset, ABG Sundal Collier

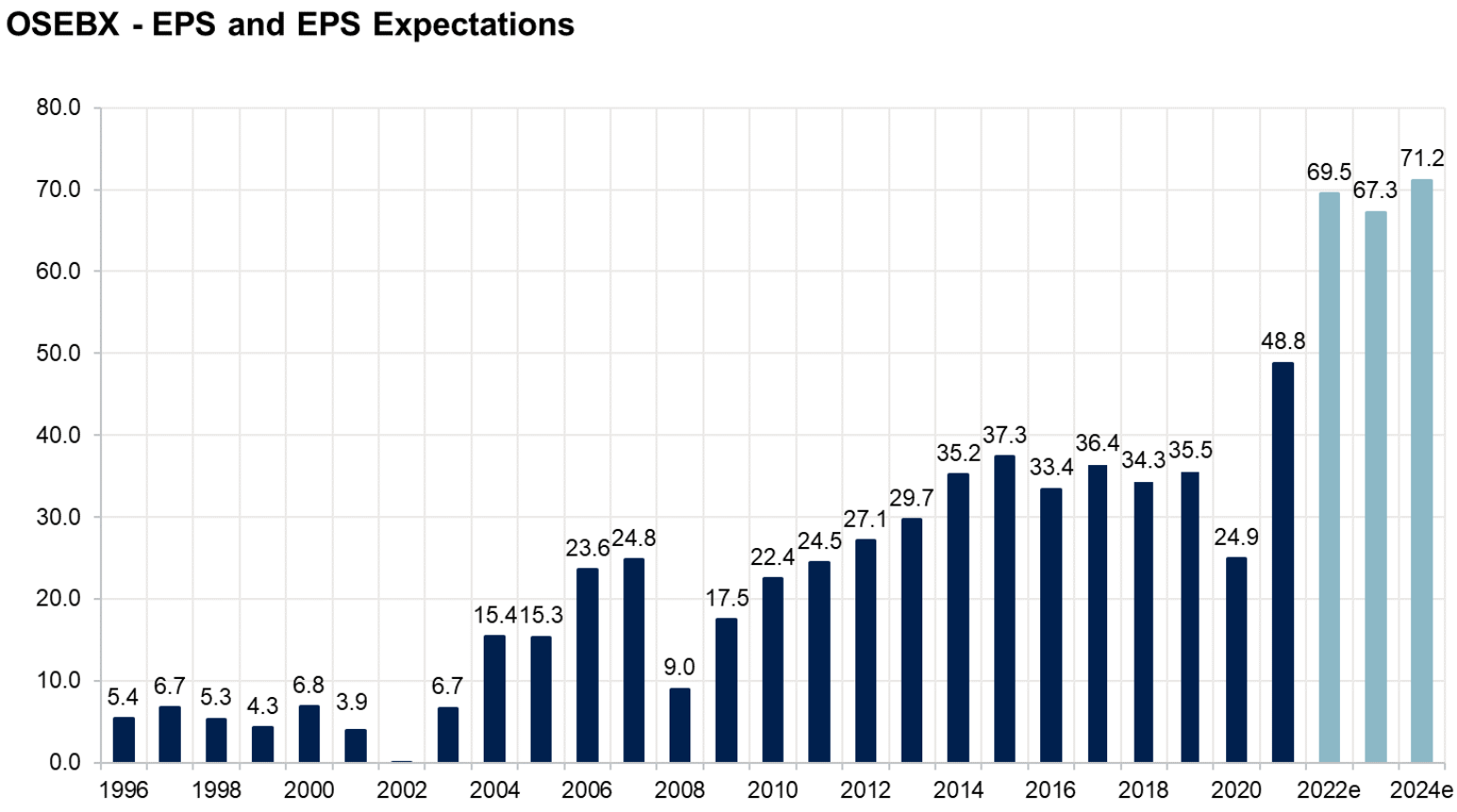
OSEBX: Earnings estimates

EPS contribution sectors OSEBX



Source: Factset, ABG Sundal Collier

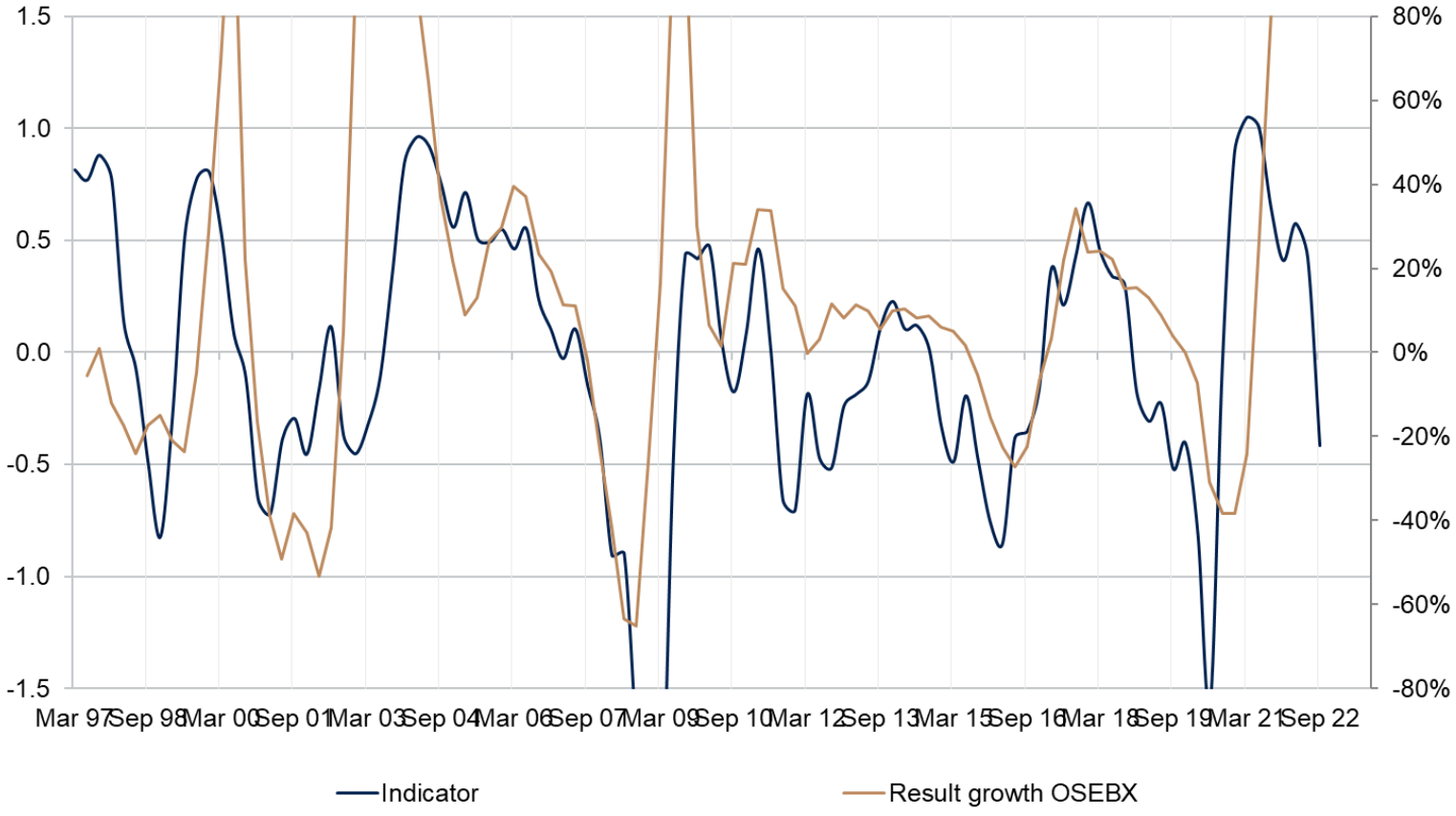
OSEBX ex Oil



Source: Factset, ABG Sundal Collier

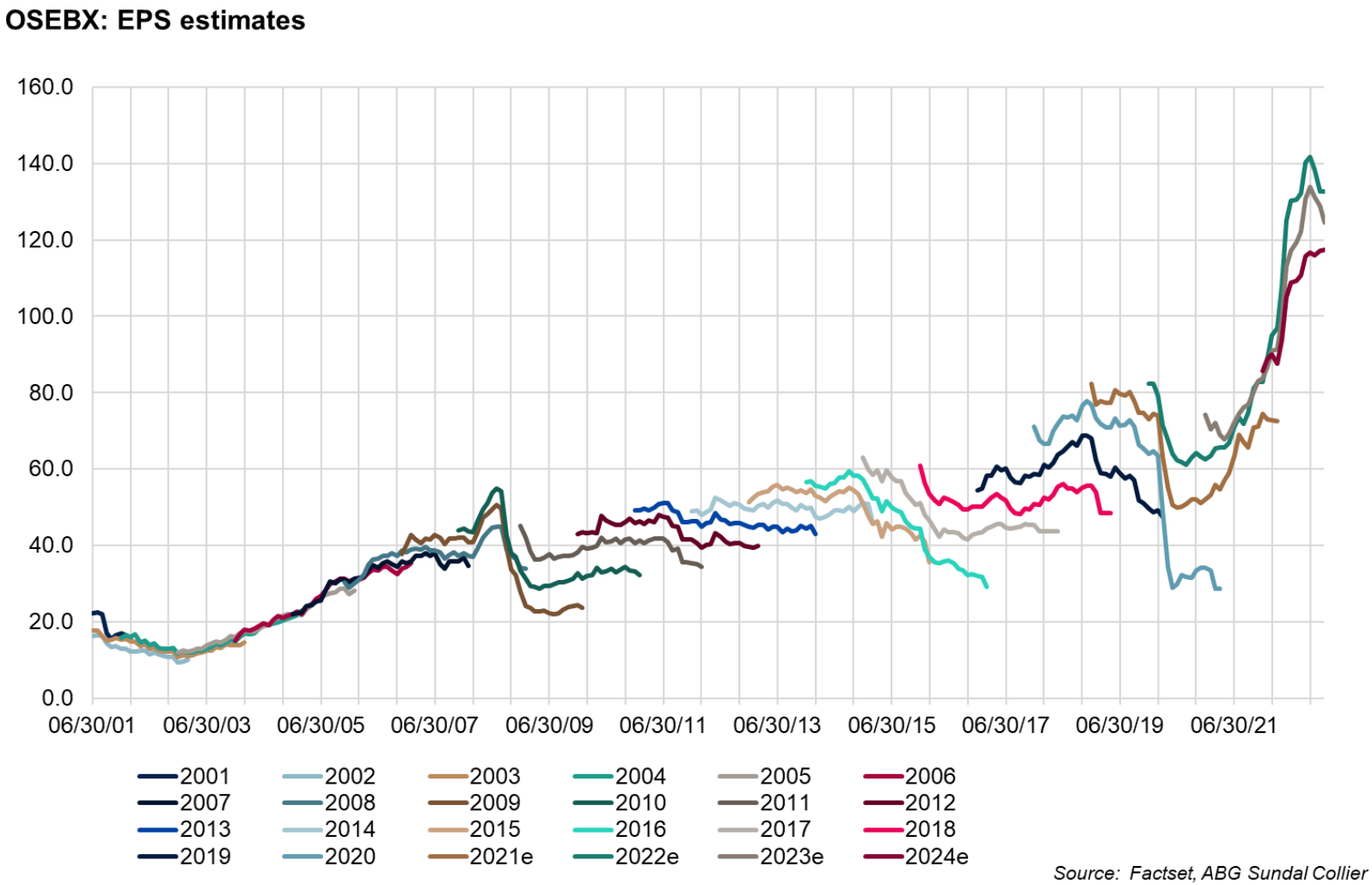
OSEBX: Result indicator

Result indicator



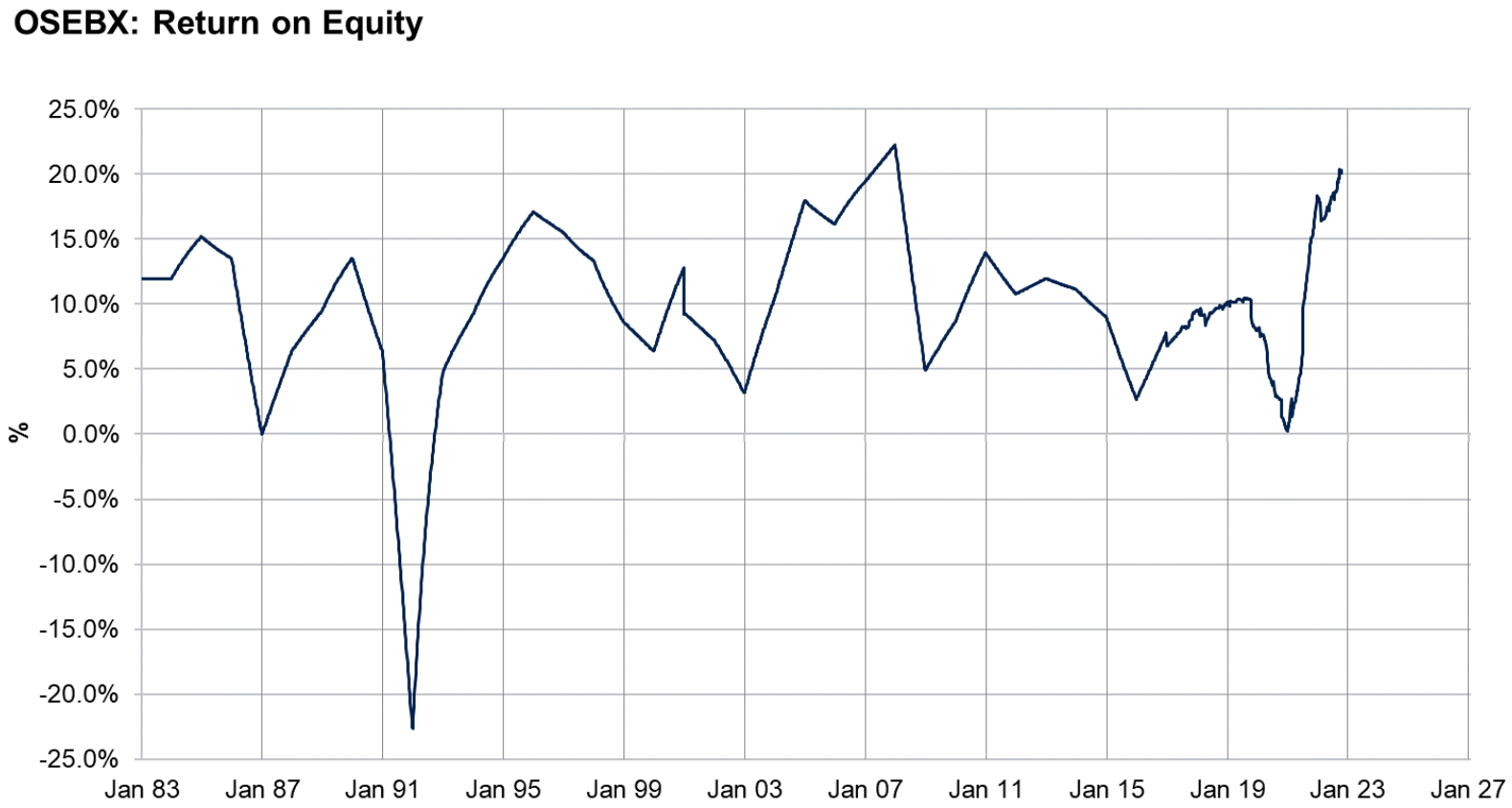
Source: ABG Sundal Collier

OSEBX: Earnings estimates



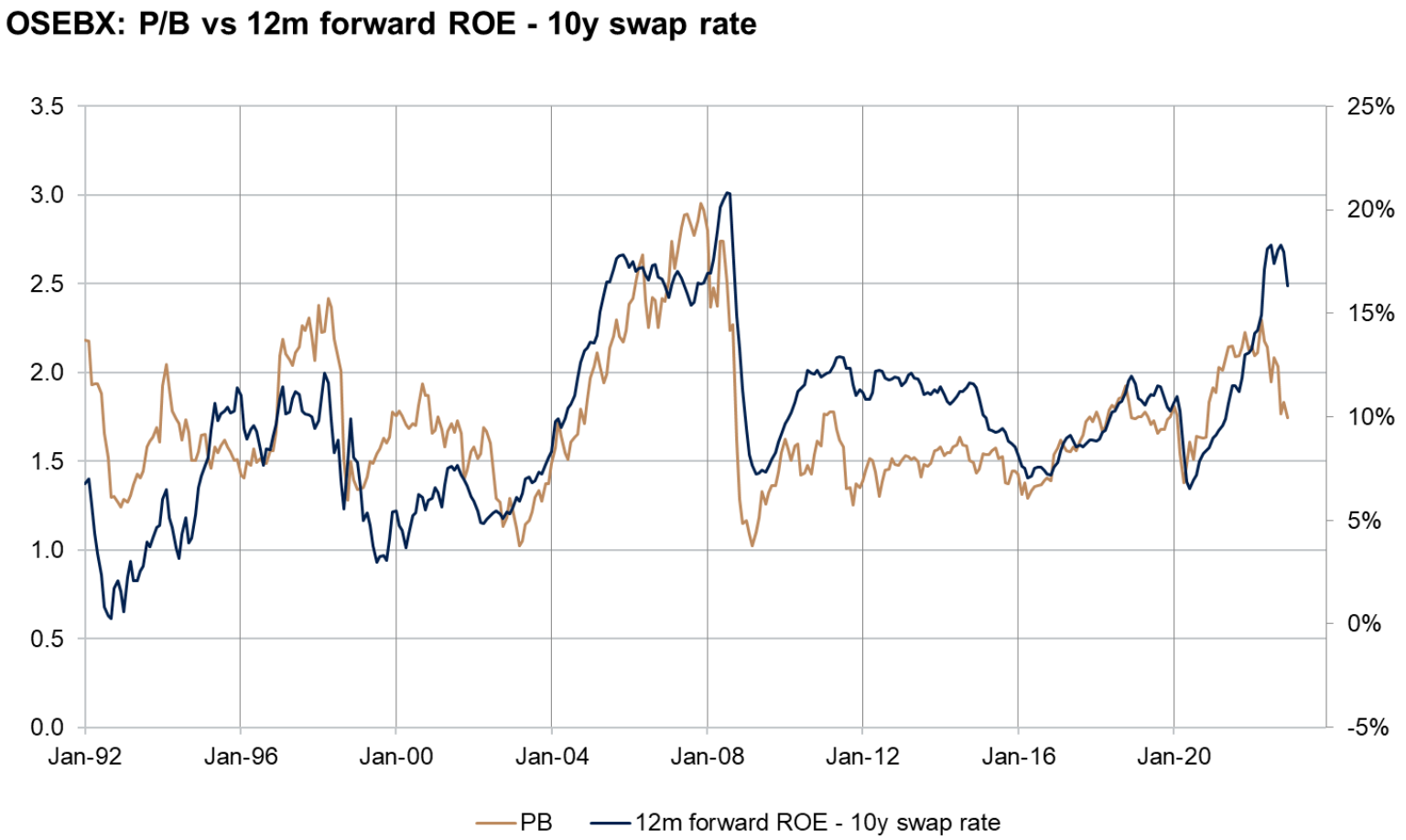
Source: Factset, ABG Sundal Collier

OSEBX: Returns



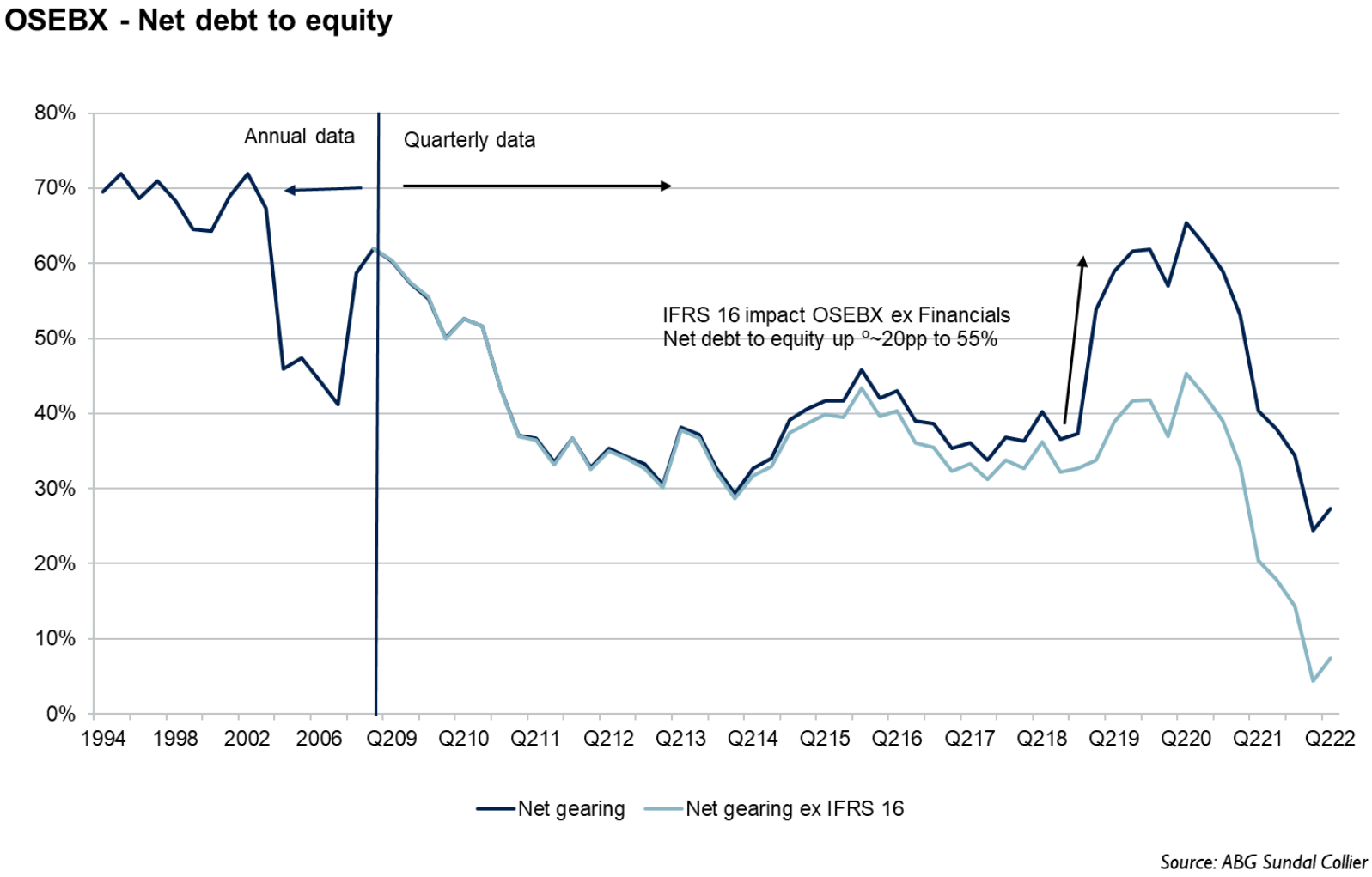
Source: NHH School of Economics, Oslo Børs, ABG Sundal Collier

OSEBX: Valuation



Source: NHH School of Economics, Oslo Børs, ABG Sundal Collier

OSEBX: Net debt to equity



Source: ABG Sundal Collier

OSEBX: Capital adj valuation

	OSEBX	Book	Net debt ex IFRS 16	P/B	EV/B
Q1'09	220	204	103	1.08	1.58
Scenario adj for IFRS 16	999	688	90	1.45	1.58
Scenario including IFRS 16	925	688	163	1.34	1.58

Disclosure

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