

GLOBAL VALUE FORECASTS

CFA Society Toronto
2014 ANNUAL Forecast Dinner

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Chairman, Brandes Investment Partners, L.P.

40 YEARS
Independent.
Always Value.
BRANDES
INVESTMENT PARTNERS

What Ben Graham Said About Forecasting

“Everybody in Wall Street is so smart that their brilliance offsets each other. And that whatever they know is already reflected in the level of stock prices, pretty much, and consequently what happens in the future represents what they don’t know.”

— Benjamin Graham

Legacy of Benjamin Graham, The Heilbrunn Center for Graham and Dodd Investing, Columbia Business School, 2013.

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What Ben Graham Said About Forecasting



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VALUE FORECASTING

Global Value Forecast

Capital Eventually Flowing to Lower Points – Value



There is no assurance that a forecast will be accurate. Because of the many variables involved, an investor should not rely on the forecasts without realizing their limitations.
Source: Brandes Investment Partners, L.P.

My Global Value Forecasts

- 1 Europe and Emerging Markets will outperform the U.S. and Canada over the next 3 years
- 2 There will be a gradual shift back to active management within the next 5 years
- 3 Equities will outperform by the widest margin on record over the next 30 years

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GLOBAL VALUE FORECAST #1

1 Europe and EM Will Outperform U.S./Canada

U.S. and Canada – Appear Fully Valued

U.S.

- Cyclically adjusted (Shiller) P/E* 25.6x vs. 134– year median 15.9x
- Corporate profit margins elevated
- Investor sentiment high: 79%
- Consumer confidence index high: 92.4
- NYSE Margin Debt all time high: \$438 billion



Canada

- 15.7x forward P/E > UK, France, Germany and Italy
- Wealth effect from commodities demand – similar to Australia
- 7.5% of work-force employed in construction
- Household debt-to-income >160%
- Financials/energy sectors appear expensive relative to global



As of June 30, 2014 except where noted.

*Sources: Prof. Robert Shiller online data: <http://www.econ.yale.edu/~shiller/data.htm>; Shiller P/E defined as inflation adjusted price to 10Y average EPS from continuing operations. CAPE (cyclically-adjusted P/E) attempts to show the relationship between price and multi-year average company earnings in order to better estimate long-term earnings power. This valuation measure seeks to smooth out earnings fluctuations caused by business cycles while also reflecting the long-term effects of inflation. Domestic Net Profit Margins from January 1947 to October 2013. St. Louis Fed. FRED Economic Data. Gross Domestic Income defined as corporate profits with inventory valuation and capital consumption adjustments for domestic industries: Profits after tax with adjustments divided by gross value added of non financial and financial corporate business. Investor Sentiment: http://www.aia.com/sentimentsurvey/sent_results; Consumer Confidence as of August 26, 2014 - <http://www.investing.com/economic-calendar/?eventid=38722&38722-Margin-Debt-as-of-July-31-2014> - http://www.mycdata.com/investdata/usa/facebookviewer_editon.asp?mode=table&key=503&category=5 Work-force employment and household debt-to-income via Statistics Canada. FactSet. Forward P/E is Price / NTMA Time-Weighted Annual estimates via FactSet Market Aggregates. Past Performance is not a guarantee of future results. One cannot invest directly in an index.



EUROPE – ATTRACTIVE VALUATIONS

On the Other Hand...



Europe at Historic Lows vs. U.S.

- Cyclically adjusted (Shiller) P/E* of 14.4x vs. 30-year median of 17.5x
- Corporate profit margins are depressed **
- Europe near historic low valuations relative to U.S.
- Value stocks appear more attractive than ever in history



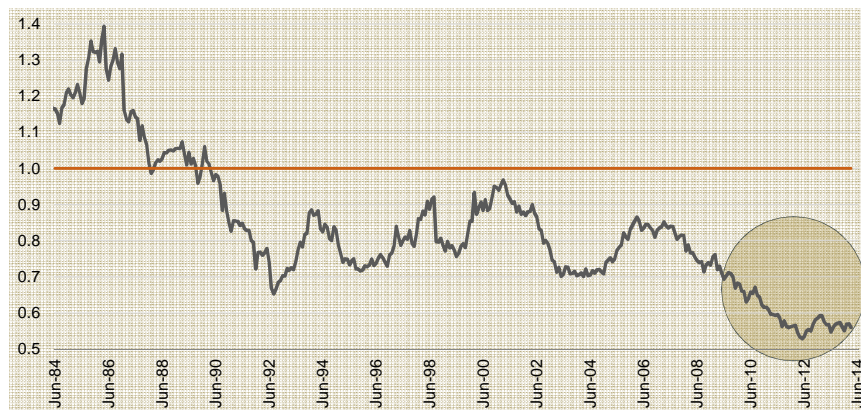
Past Performance is not a guarantee of future results. One cannot invest directly in an index.
 * Source: Prof. Robert Shiller online data: <http://www.econ.yale.edu/~shiller/data.htm>; Shiller P/E defined as inflation adjusted price to 10Y average EPS from continuing operations. CAPE (cyclically-adjusted P/E) attempts to show the relationship between price and multi-year average company earnings in order to better estimate long-term earnings power. This valuation measure seeks to smooth out earnings fluctuations caused by business cycles while also reflecting the long-term effects of inflation.
 **Source: Brandes Investment Partners, L.P.



Europe at Historic Low vs. U.S.

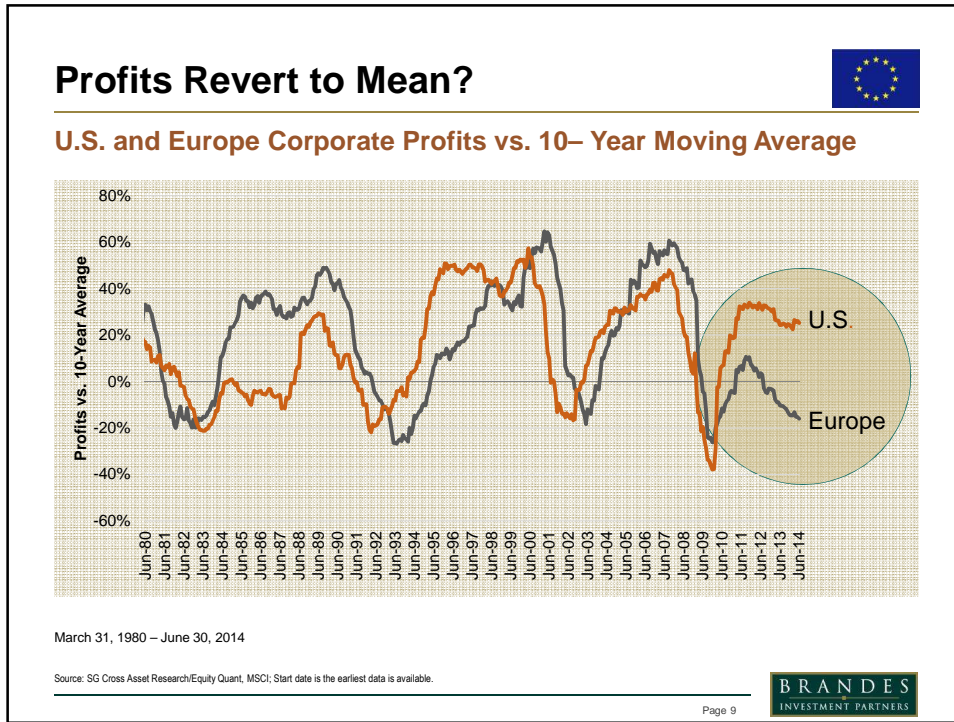


MSCI Europe Index CAPE Divided by S&P 500 Index CAPE



June 30, 1984 – June 30, 2014
 Source: Morgan Stanley, MSCI, S&P, various national sources; Shiller P/E defined as inflation adjusted price to 10Y average EPS from continuing operations. CAPE (cyclically-adjusted P/E) attempts to show the relationship between price and multi-year average company earnings in order to better estimate long-term earnings power. This valuation measure seeks to smooth out earnings fluctuations caused by business cycles while also reflecting the long-term effects of inflation. In this chart, a reading above 1.0 indicates that prices for Europe stocks are more expensive than U.S. stocks in relation to their underlying long-term company earnings. A reading below 1.0 indicates U.S. stocks are more expensive on a long-term price/earnings basis. Past Performance is not a guarantee of future results. One cannot invest directly in an index. Indices are unmanaged and cannot be directly invested into.








Emerging Markets

Not All Companies and Not All Countries are Equal

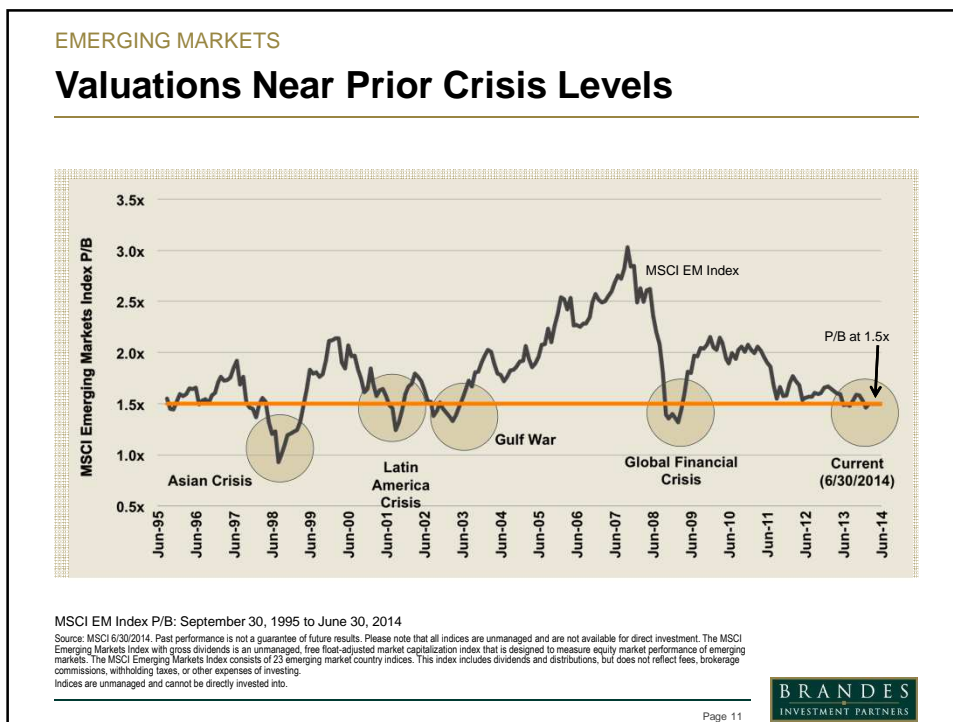
- Valuations look attractive, both absolute and relative

- Variety of Concerns:
 - Russia and Ukraine
 - China
 - Federal reserve tapering impact
 - Currency depreciation fears
 - Politics (elections, reforms)


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GLOBAL VALUE FORECAST #2

2 Gradual Shift to Active Management in 5 years

Problems with Passive Strategies

Highly correlated activity

- Amplifies pro-cyclical swings in the financial system
- Misprice risk – risk premium undergoes cycles of feast or famine

“The move into passive and tracking strategies increases the potential for investor herding and correlated market movements. Both potentially have implications for financial markets dynamics and systemic risk.”

- Andrew Haldane

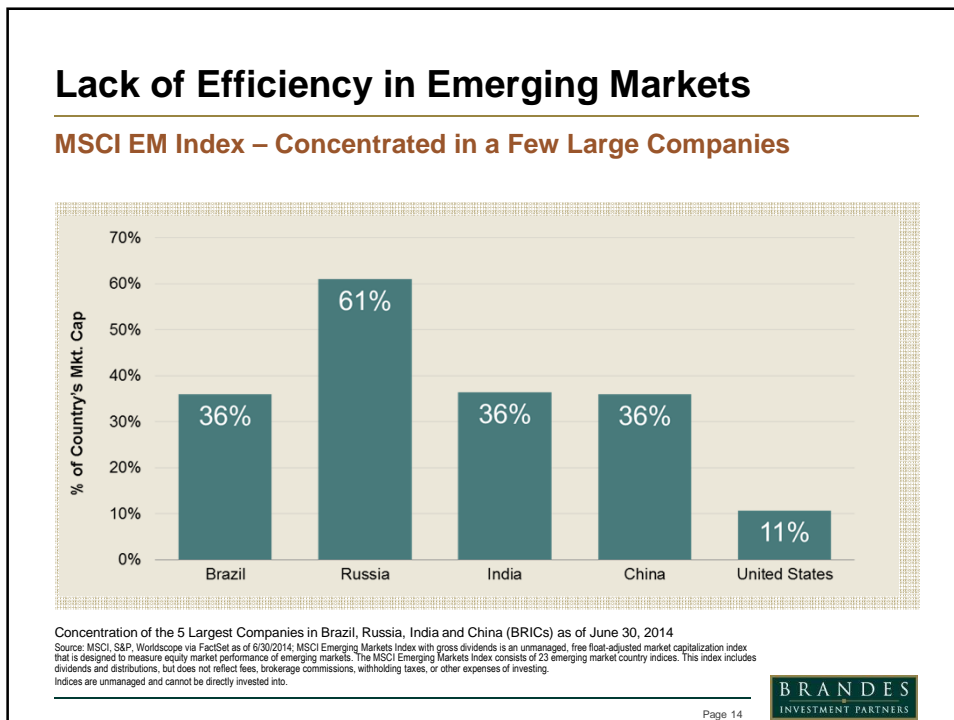
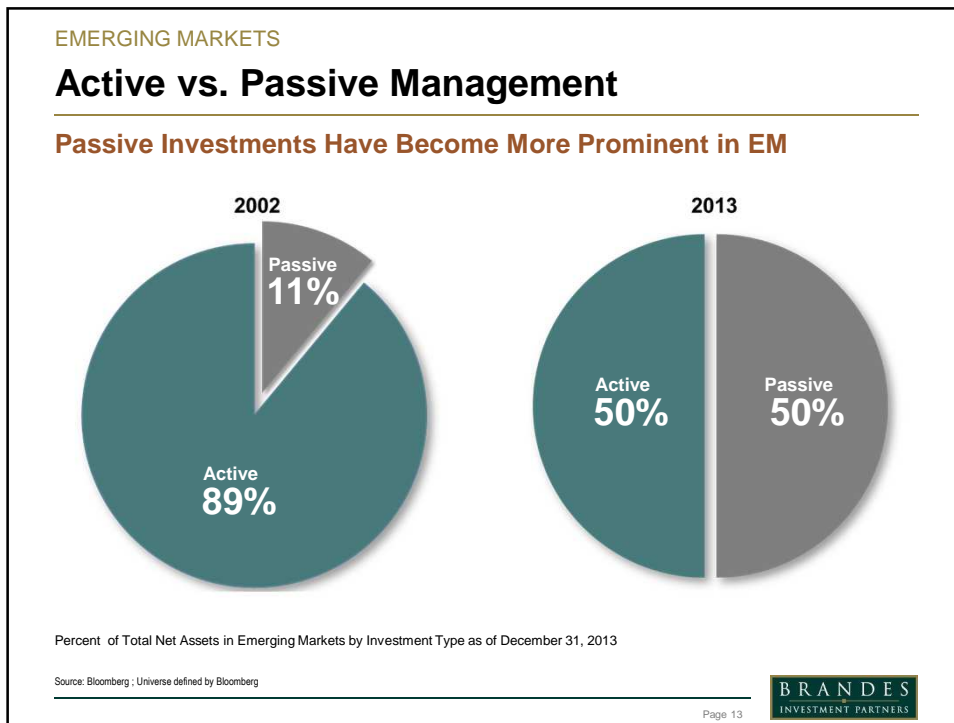



Andrew Haldane
Executive Director of
Financial Stability,
Bank of England

Source: <http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech723.pdf>; April 4, 2014.
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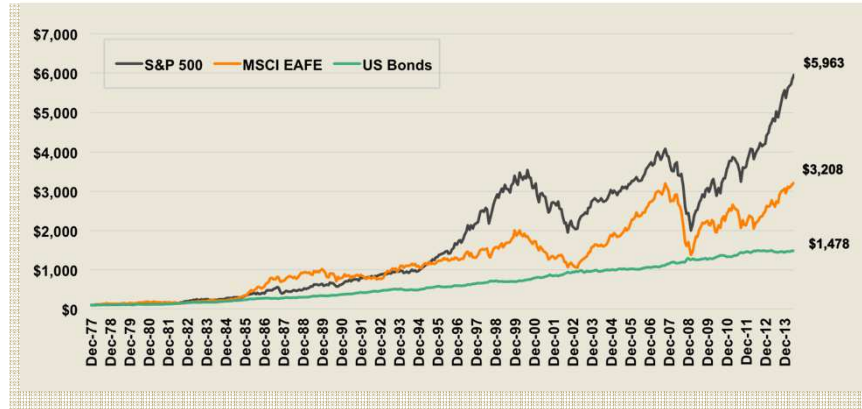
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GLOBAL VALUE FORECAST #3

3 Equities Will Outperform Bonds Over the Next 30 Years

By Widest Margin On Record



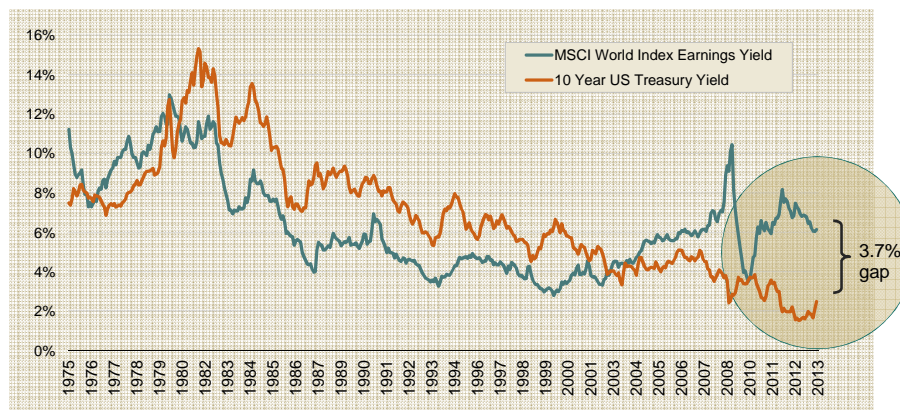
Cumulative Growth 1970-2013
*Assuming a hypothetical initial investment of \$100

Source: Brandes, based on data from Ibbotson, FactSet, MSCI and S&P as of 4/30/13. Past performance is not a guarantee of future results. S&P 500 index via Ibbotson; MSCI EAFE via MSCI; US Bonds (US Long-Term Government 10-year Bond) via Ibbotson. This hypothetical example is for illustrative purposes only. It does not represent the performance of any particular investment. Actual results may vary. One cannot invest directly in an index. Indices are unmanaged and cannot be directly invested into. There is no assurance that a forecast will be accurate. Because of the many variables involved, an investor should not rely on the forecasts without realizing their limitations.



Wide Gap Between Earnings Yield and Bond Yield

MSCI World Index Earnings Yield vs. 10-Year U.S. Treasury Yield



June 30, 1975 to June 30, 2013

Source: MSCI, FactSet & Morgan Stanley, as of June 30, 2013. Past Performance is not a guarantee of future results. One cannot invest directly in an index. Indices are unmanaged and cannot be directly invested into.



My Global Value Forecasts

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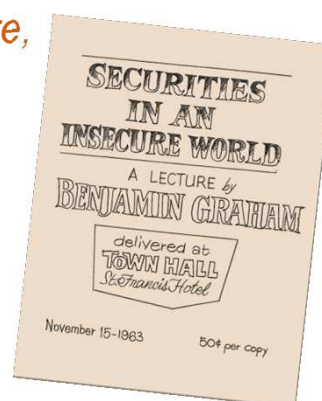


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Global Value Forecasts

“What happens in the future, we don't know.”

“If you base decisions on value, you will.”



GLOBAL VALUE FORECASTS

GLOBAL EQUITIES VALUE LEGEND

LESS OPPORTUNITY VALUE OPPORTUNITY

Thank You

40 YEARS
Independent.
Always Value.

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Forward Price/Earnings: Price per share divided by forecasted earnings per share, typically for the next 12 months.

Price/Book: Price per share divided by book value per share.

Yield : Annual income from the investment (dividend, interest, etc.) divided by the current market price of the investment.