Global Equity Strategy

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STRATEGY

Equities: A pause before further advances

We stick to our long-standing overweight of equities and our end-2014 target of 1,900 on the S&P 500. Markets have surpassed our end-2013 target (of 1,730 on the S&P 500) and **we see a heightened risk of near-term consolidation** as:

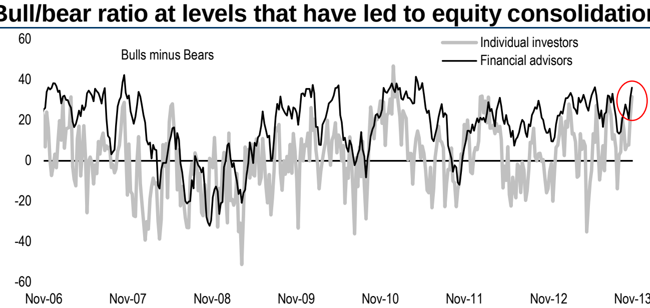
- **Some tactical indicators are signalling caution:** The bull/bear ratio, director selling, and the gap between sector risk appetite and overall risk appetite have all reached extreme levels associated with marginal market falls on our back-tests. In addition, corporate net buying has slowed to zero (from 3% of market cap), again a precursor to consolidation.
- **Earlier Fed tapering than the market expects:** we agree with our US economics team that tapering is more likely to start in January than in March, largely because the market is too pessimistic on 2014 US growth prospects.
- **Earnings revisions** have underperformed macro momentum.
- **Growth momentum:** macro surprises have yet to recover post their September fall, but we think they will.

However, we stress that the risk is consolidation in the near term, not a correction and we believe that markets in 6 and 12 months' time will be significantly higher. Hence, **we stick to our overweight of equities.**

Factors that underpin equities strategically are: cheap relative valuations (the US ERP is 5.4%, compared to our warranted level of 4.5%); excess liquidity (rising 6.3% a year); inflation expectations, we believe, are set to rise (a positive for equity multiples); long-term positioning is cautious (retail/institutions have sold c.$200bn of equities since 2008); US EPS growth is set to be 7% in 2014E (we upgrade European EPS from 7.5% to 10.5%); and, finally, global GDP growth is likely to accelerate to 3.8% in 2014E, from 2.7% in Q2. Ultimately, we believe equities will peak when risk appetite is in euphoria, rates rise or when equities start to be expensive against bonds (caused by US 10-year yields rising above 3½%). The main risk, in our view, is that US growth will be too strong in 2014 (triggering sharper-than-expected tapering) or China too weak.

(Note: This is Investment Banking research not Private Banking research)

Figure 1: **Bull/bear ratio at levels that have led to equity consolidation since 2007**



Source: Thomson Reuters, Credit Suisse research

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Equities: A pause before further advances

Markets have risen through our year-end targets over the past month (of 1,730 on the S&P 500). We now shift focus to our end-2014 target, which we leave unchanged at 1,900 (implying a total return of just over 10% in US equities). **However, we think that there is likely to be near-term consolidation.**

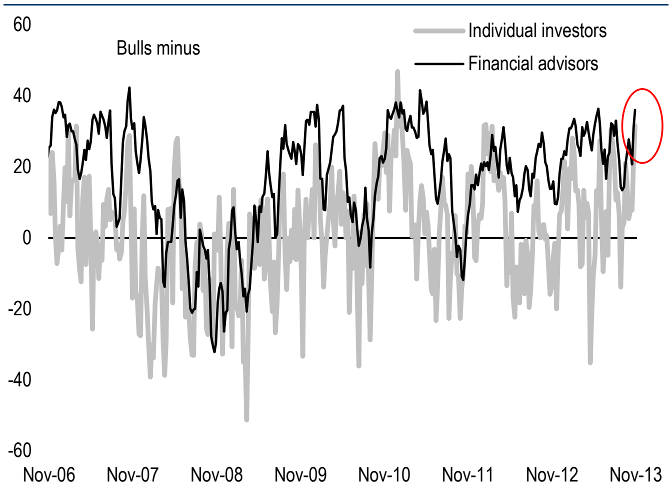
Importantly, we believe that equities will be meaningfully higher in 6 and 12 months' time and will have outperformed both bonds and cash. Thus, we keep our overweight of equities in place as we do not see sufficient near-term downside risk to allow the tactical weighting to be different from the strategic weighting.

Near-term risks

1) Some of the tactical indicators have become more extended

- **The bull/bear ratio** for financial advisors has risen to levels that on 6 out of the past 7 occasions have been followed by a period of consolidation in the following 1 or 2 months (with an average correction of 6%, and with a correction of greater than 10% only once).

Figure 2: **The bull/bear ratio is extended**



Source: Thomson Reuters, Credit Suisse research

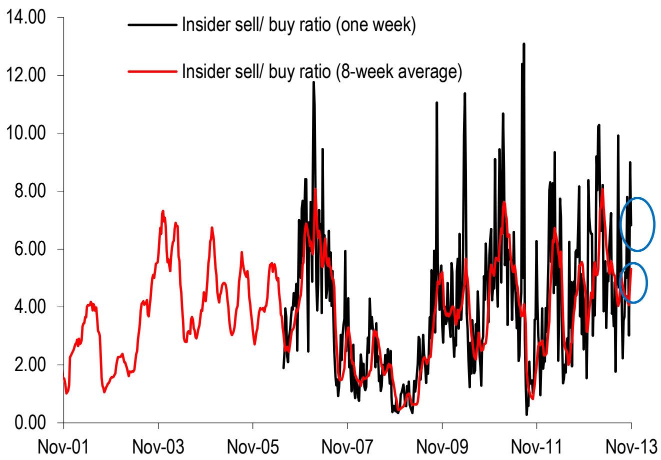
Figure 3: **On 6 of the past 7 occasions since 2007 that the bull/bear ratio has been at this level, there was a period of consolidation**

Date when fin adv bull bear ratio rose to current level	S&P 500 perf since fin adv bull bear ratio rose to current Level				
	2-week	1-month	2-month	3-month	Maximum correction
Jun-07	0%	4%	-3%	-1%	-6%
Oct-07	-3%	-7%	-3%	-10%	-10%
Dec-09	2%	3%	-3%	5%	-5%
Apr-10	-3%	-10%	-8%	-11%	-15%
Nov-10	0%	6%	10%	13%	0%
Apr-11	-2%	1%	-3%	0%	-2%
May-13	-2%	-5%	2%	-2%	-6%
Average	**-1.1%**	**-1.3%**	**-1.2%**	**-0.7%**	**-6.2%**
Median	**-1.5%**	**0.6%**	**-2.9%**	**-1.4%**	**-5.8%**
Typical	**0.1%**	**0.4%**	**0.8%**	**1.2%**	
% rise	**29%**	**57%**	**29%**	**43%**	

Source: Thomson Reuters, Credit Suisse research

- **The insider (i.e. directors) sell/buy ratio has also picked up** quite sharply, and last week reached levels that have typically been associated with consolidation (an average fall in the market of 1.5% over the next two months).

Figure 4: Insider (i.e. directors) selling has risen sharply



Source: Argus Vickers, Credit Suisse research

Figure 5: …and on previous occasions it rose to the recent highs, historically the S&P 500 dipped by 1.5% on a two-month view

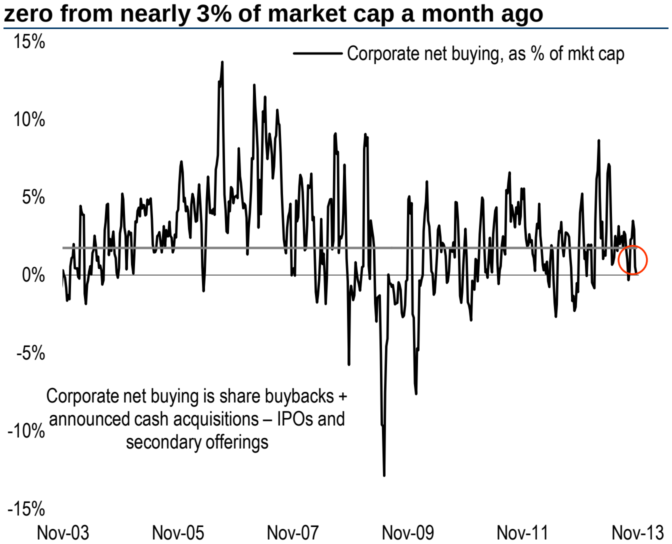
Date when insider sell/buy ratio rose to current level	S&P 500 perf since insider sell/buy ratio rose to current Level 2-week	1-month	2-month	3-month
Feb-07	1%	-3%	1%	5%
Sep-09	-2%	3%	3%	5%
Apr-10	0%	-11%	-7%	-10%
Dec-10	1%	3%	7%	3%
Jul-11	1%	-11%	-13%	-9%
Mar-12	1%	-2%	-8%	-4%
Feb-13	2%	3%	4%	9%
Jul-13	1%	-2%	1%	3%
Average	**0.6%**	**-2.5%**	**-1.5%**	**0.3%**
Median	**0.9%**	**-2.3%**	**1.1%**	**3.4%**
Typical	**0.1%**	**0.2%**	**0.5%**	**0.8%**
% rise	**88%**	**38%**	**63%**	**63%**

Source: Argus Vickers, Credit Suisse research

- **Corporate net buying has fallen to nearly zero**

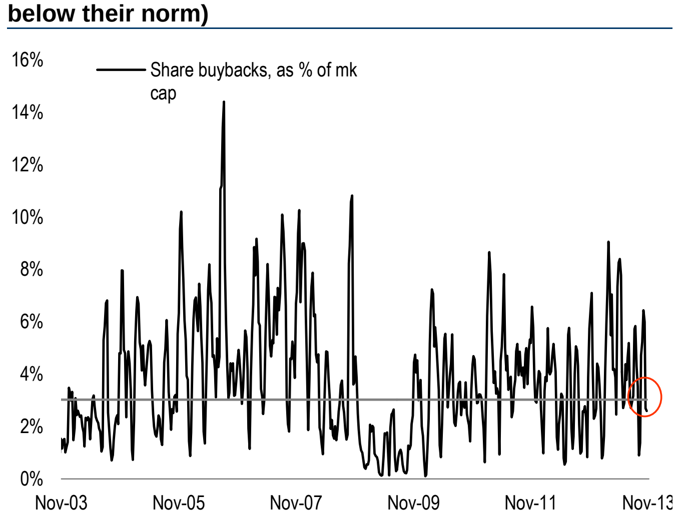
US corporate net buying (calculated as share buybacks plus announced cash acquisitions less IPOs and secondary offerings) has fallen to close to zero. This has been driven by very low announced cash takeovers, above-average new equity issuance and share buybacks having dipped slightly below their norm (which is unusual at this stage of the reporting season).

Figure 6: US corporate net buying has fallen to close to zero from nearly 3% of market cap a month ago



Source: Trim Tabs, Credit Suisse research

Figure 7: Share buybacks are 2.6% of market cap (15% below their norm)



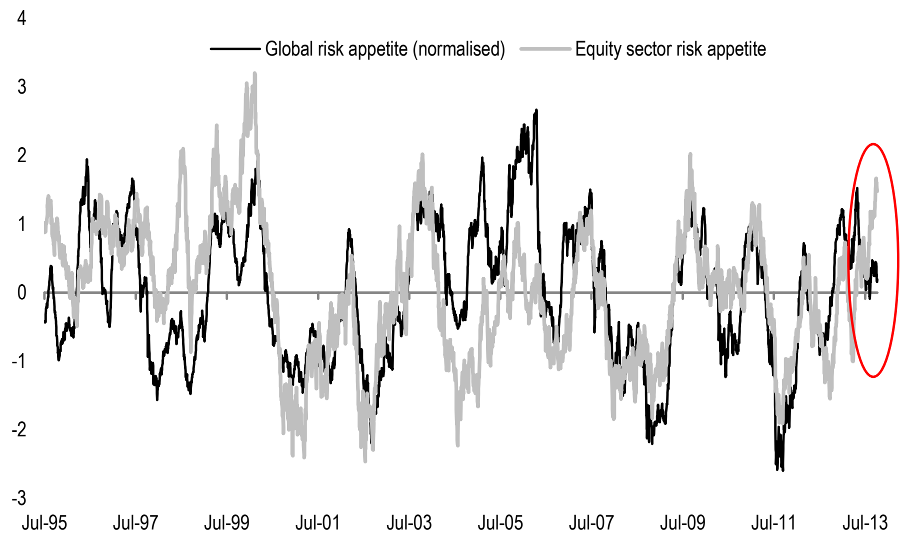
Source: Trim Tabs, Credit Suisse research

On previous occasions when US corporate net buying fell from 3% of market cap to zero, the correction within the following three months has been around 7%, on average. This is shown in Appendix 3.

- **Equity *sector* risk appetite** has moved well ahead of overall risk appetite.

Equity sector risk appetite is currently +1.48σ, while global risk appetite is just +0.16σ suggesting that portfolio managers are more bullish than asset allocators. Such a degree of decoupling is rare.

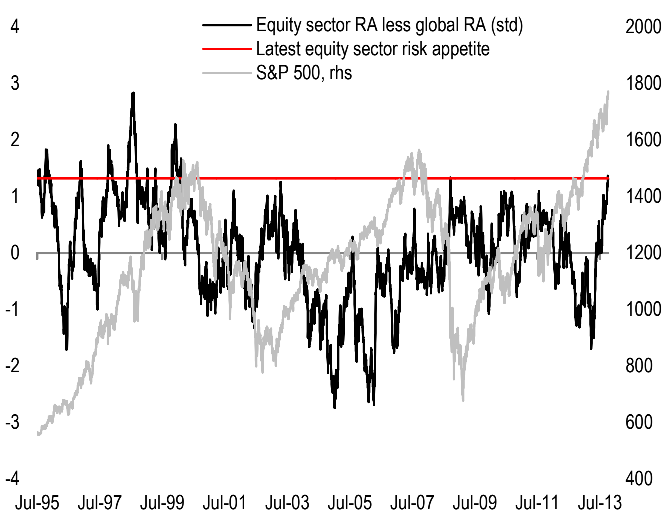
Figure 8: There has been a decoupling between equity *sector* risk appetite (which is extended) and overall risk appetite (which is just above average)



Source: Thomson Reuters, Credit Suisse research

We have looked at market performance during and after periods when equity sector risk appetite is above +1σ and is more than 1σ above global risk appetite. This has not been the case since 2000 and there have been 7 such periods in the past 20 years. In the three months after equity sector risk appetite is extended in absolute terms and relative to global risk appetite the correction has averaged 6.3%.

Figure 9: Equity risk appetite has not been this extended relative to global risk appetite since 2000



Source: Thomson Reuters, Credit Suisse research

Figure 10: Equities tend to correct by 6.3% after equity sector risk appetite is extended in absolute terms and relative to global risk appetite

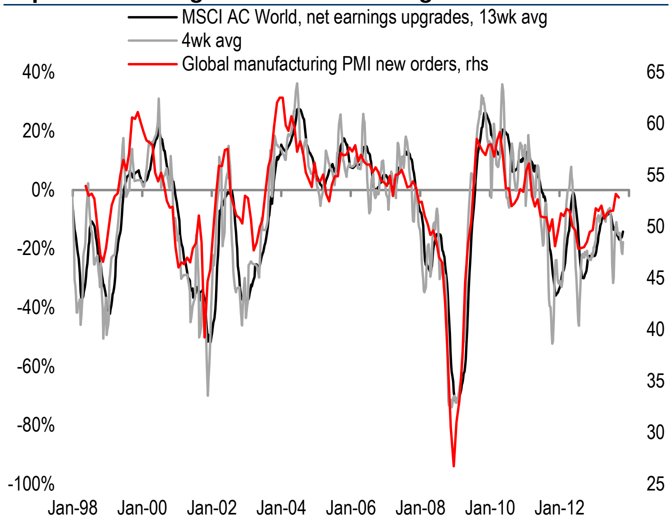
Start	End	Max correction in the 3m from start date	Max correction during the dates shown and including the following 3m
27-Jul-95	06-Sep-95	-1.8%	-1.8%
19-Oct-95	03-Nov-95	-2.4%	-2.4%
07-Nov-96	23-Dec-96	-0.9%	-4.8%
08-Oct-97	29-Oct-97	-9.9%	-9.9%
22-Jun-98	02-Sep-98	-13.2%	-19.3%
08-Apr-99	13-May-99	-4.7%	-6.3%
28-Sep-99	07-Mar-00	-2.7%	-9.2%
	Average	-5.1%	-7.7%
	Median	-2.7%	-6.3%

Source: Thomson Reuters, Credit Suisse research

2) Earnings revisions have undershot macro momentum

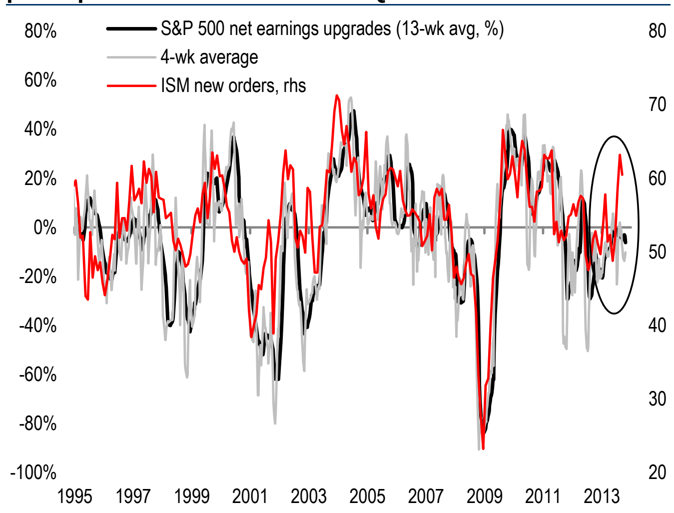
Global earnings revisions have lagged the improvement in global manufacturing new orders. This is particularly apparent in the US, where earnings momentum did not respond positively to the sharp pick-up in ISM Manufacturing new orders through the third quarter. The 13-week m.a. of earnings revisions are marginally stabilising (this tends to be more reliable than the 4-week m.a., which is affected by the timing of the reporting season).

Figure 11: **Global earnings revisions have lagged the improvement in global manufacturing new orders**



Source: Thomson Reuters, Credit Suisse research

Figure 12: **US earnings revisions did not respond to the pick-up in macro momentum in Q3**



Source: Thomson Reuters, Credit Suisse research

3) Too much optimism on Fed tapering

The consensus expects the first tapering of Fed asset purchases to be in March (although the survey was struck just prior to the latest FOMC meeting, which proved to be marginally more hawkish than expected), while our economists believe it is likely to be January (see ***US Money Matters: FOMC Meeting Preview - Poor Visibility***).

On the global strategy team, we believe that the Fed will be more dovish than the market expects for any given level of growth, but US GDP growth is likely to a bit stronger than investors now expect in 2014. As a result, we agree with our US economics team that the risk is that tapering starts earlier.

We would highlight that US GDP is 1.6% year-on-year, even after fiscal tightening of 2.5% of GDP. Next year, fiscal tightening could be just 0.75% of GDP and as a result, the change in the fiscal stance could add nearly 1½% to US GDP growth. Thus, US GDP growth could end up being closer to 3% to 3½% next year.

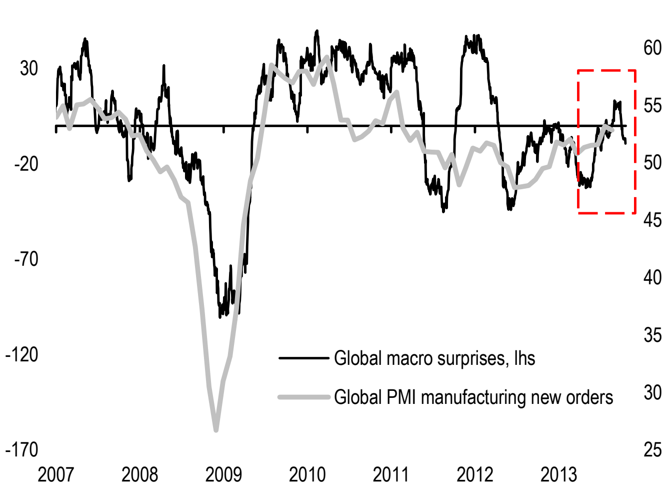
We believe that there has been too much pessimism on the interest rate-sensitive components of US growth: the NAHB (see appendix 2) is consistent with 1.5m housing starts and housing adding another 2% to GDP growth over the rest of the cycle. Housing affordability on all measures is still attractive, and US house prices on the latest data are up 12.8% year-on-year, the highest annual growth rate since February 2005. In addition, housing inventories are still below their norm, and under half of peak levels.

If anything, the bond market now appears realistic in its estimate of the first rate hike (May 2015), whereas previously we had thought that the bond market was too pessimistic.

4) A short-term pause in macro momentum before growth re-accelerates

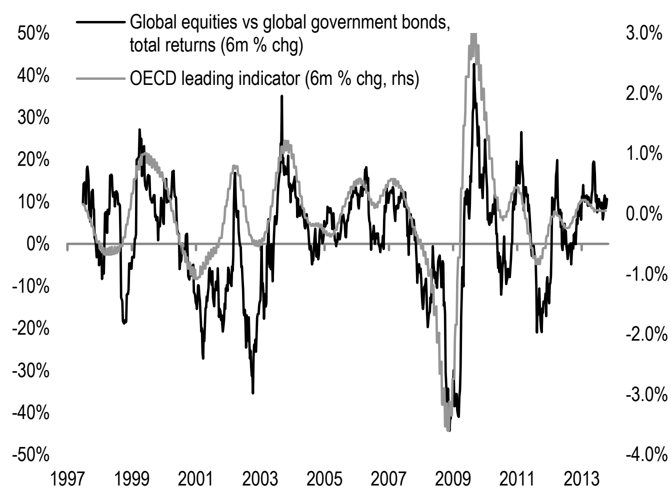
- Macro surprises have edged lower in recent weeks, and there is a close correlation between global growth and the relative performance of equities against bonds.

Figure 13: **Global macro surprises seem to be stabilising in the middle of their historic range**



Source: Thomson Reuters, Credit Suisse research

Figure 14: **The OECD lead indicator remains at a level consistent with equity outperformance of bonds**

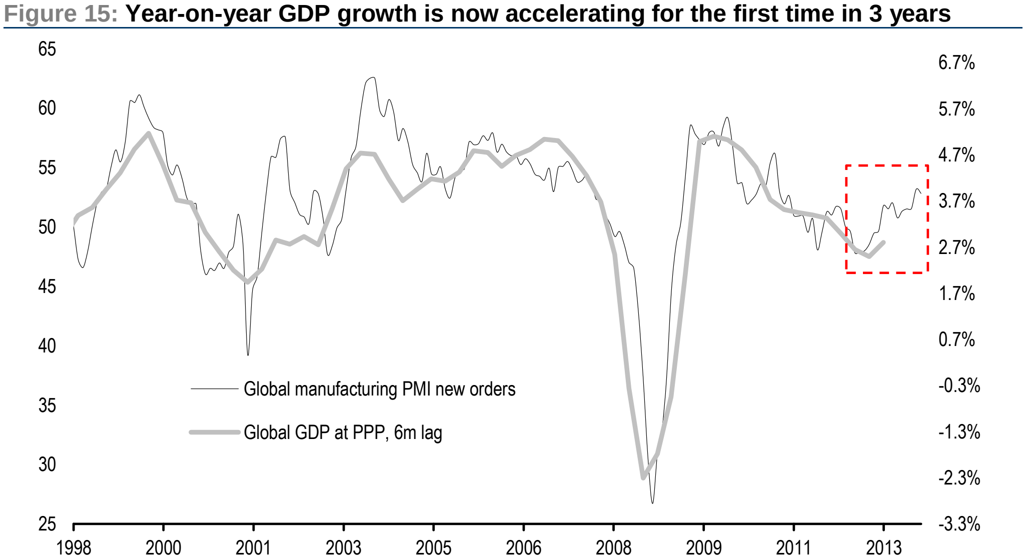


Source: Thomson Reuters, Credit Suisse research

- Our view remains that this is merely a mid-cycle pause reflecting rising US bond yields (and, as above, we think these concerns are overstated) and a postponement of spending decisions over the debt ceiling negotiations. (The tendency for small initial downturns in global economic momentum to turn into sharp corrections has diminished over the past year because of the removal of self-perpetuating negative feedback loops with the potential backstop of an OMT programme in Europe).

We continue to believe that macro surprises will end up rebounding to higher levels (as they normally do), and that year-on-year GDP growth is accelerating for the first time in three years. PMIs are consistent with annual global GDP growth accelerating to 3.7%, compared to 2.7% in Q2 2013. This would put global GDP marginally above its 30-year CAGR of 3½%.

Figure 15: **Year-on-year GDP growth is now accelerating for the first time in 3 years**



Source: Thomson Reuters, Credit Suisse research

Continue to be overweight equities

We believe that any consolidation will be short-lived and thus we stick to an overweight in equities on a 6- to 12-month view. We tend not to take a different tactical (3-month) view unless all the tactical indicators are obviously signalling caution, which currently they are not. We would highlight five main reasons for our optimism on equities:

1) Equities are still cheap against bonds

The US ERP is still high at 6.8% using IBES consensus earning numbers. On our earnings numbers, the US ERP is 5.4%.

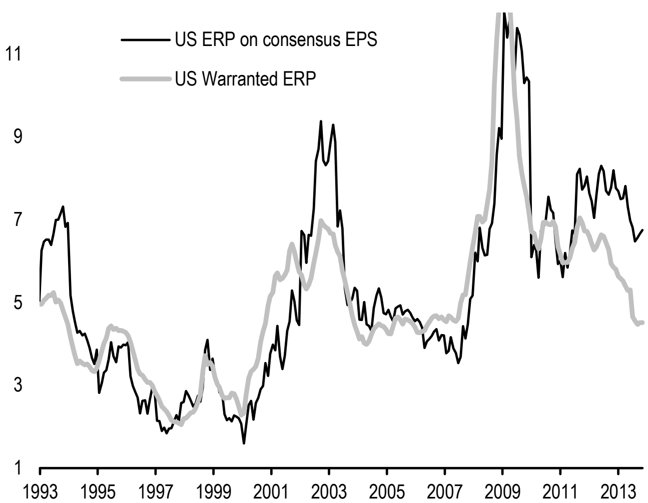
Figure 16: **US equity risk premium (ERP) on consensus earnings is 6.8% and 5.4% on our earnings forecast**

US ERP	12mth fwd EPS	12-24mth fwd EPS growth	3-5yr fwd EPS growth	ERP
ERP on 12m forward consensus EPS estimates	$118.9	10.7%	11.2%	6.8%
ERP on our EPS forecasts	$113.5	6.4%	6.4%	5.4%
ERP on trend operating EPS of $82	$82	6.4%	6.4%	4.6%
Historical 110- year average equity risk premium				**3.2%**

Source: Thomson Reuters, Credit Suisse research

Our model of the warranted ERP (our estimate of where we think the ERP should be given the current stage in the cycle and credit spreads) suggests that it should be around 4.5%.

Figure 17: **The gap between the actual and warranted equity risk premium remains abnormally high**



Source: Thomson Reuters, Credit Suisse research

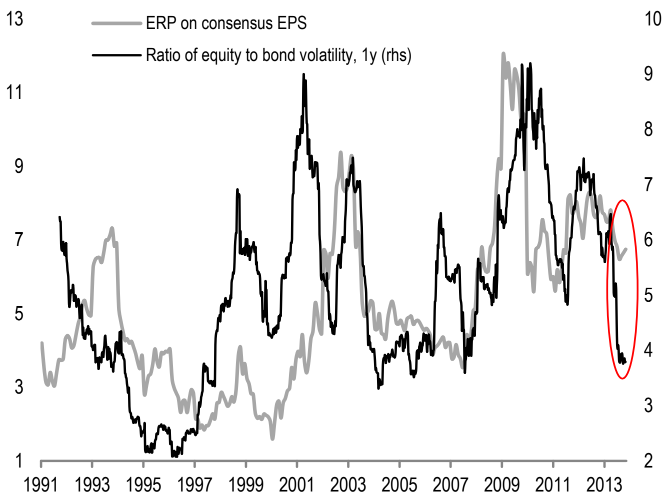
Figure 18: **Our model, based on the output gap and credit spreads, implies a warranted ERP of 4.5%**

Model inputs	Coeff.	*t-value*	Current
US lead indicator - dev. from trend	-0.55	*-13.0*	1.49
BAA Corp. bond spread	0.94	*7.9*	2.71
Model output			
US warranted ERP (consensus, operating)			4.5
Current ERP on consensus EPS			6.8

Source: Thomson Reuters, Credit Suisse research

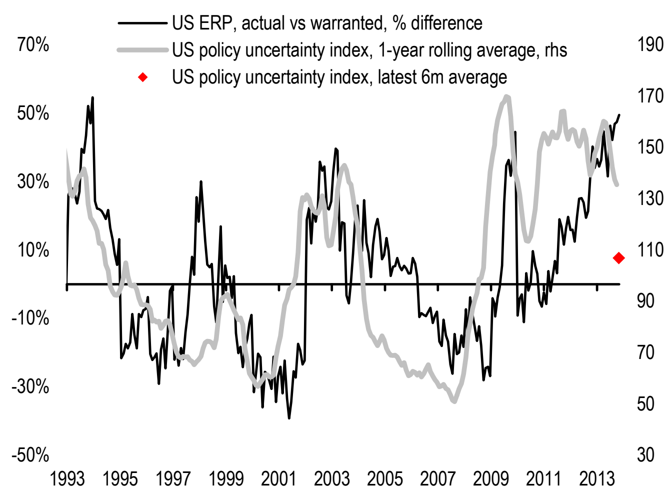
Equity-to-bond volatility and macro uncertainty are consistent with the ERP falling below 4.5%.

Figure 19: The ratio of equity to bond volatility is consistent with a fall in the ERP to around 4%



Source: Thomson Reuters, Credit Suisse research

Figure 20: The gap between the actual equity risk premium (ERP) and the warranted ERP should continue to close as macro uncertainty falls



Source: Thomson Reuters, Credit Suisse research

On our models, we estimate that equity to bond valuations become neutral when the US 10-year bond yield rises to 3¼% to 3½% (once we adjust for the impact of rising bond yields on the interest charge, GDP growth and valuation).

Figure 21: Impact of higher rates on earnings, housing, GDP and equity valuations

Impact of higher interest rates				
100 bps on corporate bond yields	->	30 bps on interest charge	->	3% off US earnings
100 bps on the mortgage rate	->	Mortgage rate goes to 5.6%	->	Housing affordability falls to average
100 bps on the 10-yr Treasury yield	->	Sensitivity based on OECD model	->	GDP level falls by 0.1% in yr1 to 1.1% in yr5
100 bps on the 10-yr Treasury yield	->	Sensitivity based on CS savings ratio model	->	GDP falls by 0.4%
100 bps on the 10-yr Treasury yield	->	Impact on equity valuations	->	Bond yield of 3.65% causes ERP to falls to warranted ERP

Source: Thomson Reuters, Credit Suisse research

2) Easy monetary and less tight fiscal policy remains supportive for equities

Outside of the US, we think that monetary policy will surprise on the dovish side:

- The ECB could easily implement another LTRO or cut the deposit rate (the rationale being that inflation is just 0.7%, with core inflation of 0.8%), the monetary transmission mechanism is still broken, with real lending rates to SMEs in the periphery at 6% - more than double those of the core European countries – with 40% of SMEs in the periphery having little or no access to bank finance.
- We would also expect the BoJ to step up QE in Q1 2014 (as Japanese wages-not wage growth- are now declining again and our economists believe that on current policies, Japanese inflation will be just 0.5% next year).
- It is striking that the Fed project 5.7% unemployment by end-2016 (which is close to their own estimate of full employment) and even then only forecast a 1.75% Fed Funds rates, which in real terms is slightly below zero and still highly accommodative

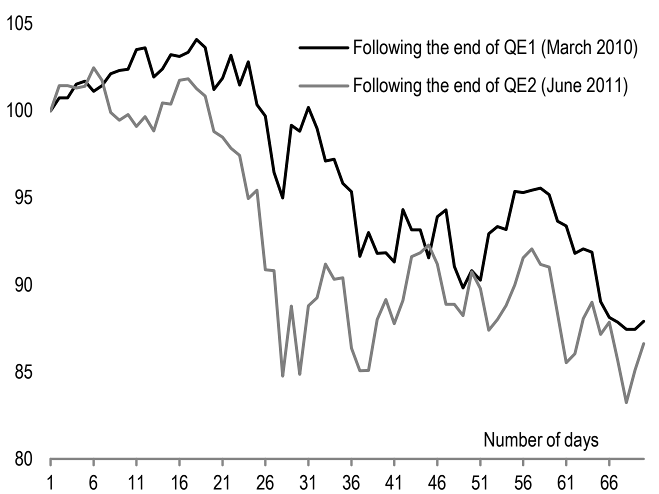
(historically the real Fed Funds rate has averaged 2%, and the Fed estimate the long-run nominal Fed funds rate to be 4%).

The net result is that developed market central bank balance sheets are likely to expand by another 16% between now and end-2014, and partly as a result of this excess liquidity is running at 6.3%, as shown below.

We would also note that equities only corrected two weeks *after* the end of QE 1 and QE 2. Our economists expect QE 3 to finish in September 2014.

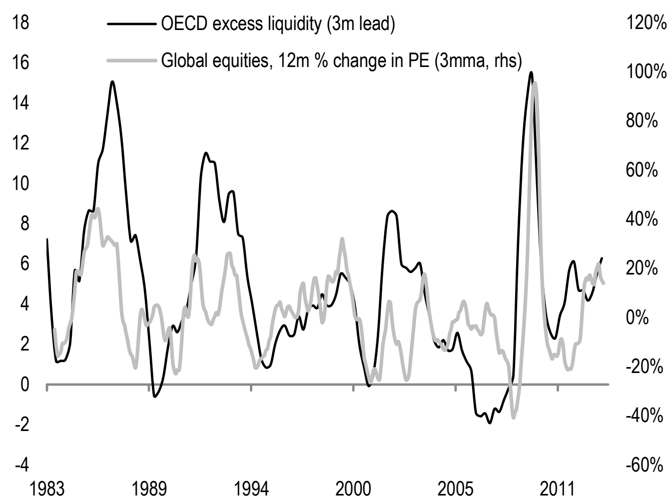
We still believe that the problematic time for equities is likely to be the period around the first rate hike (mid 2015, in our view) and when the cost of capital changes at the short end, this will drive a period of deleveraging. For the record, the first rate hike in the previous six rate cycles has seen a market correction of 2.2% to 8.7% in the S&P 500, a similar scale to the correction that occurred following the 22 May FOMC meeting.

Figure 22: **Market peaks after the end of QE 1 and QE 2**



Source: Thomson Reuters, Credit Suisse research

Figure 23: **Global excess liquidity rising at c6% appears supportive of equity market valuations**



Source: Thomson Reuters, Credit Suisse research

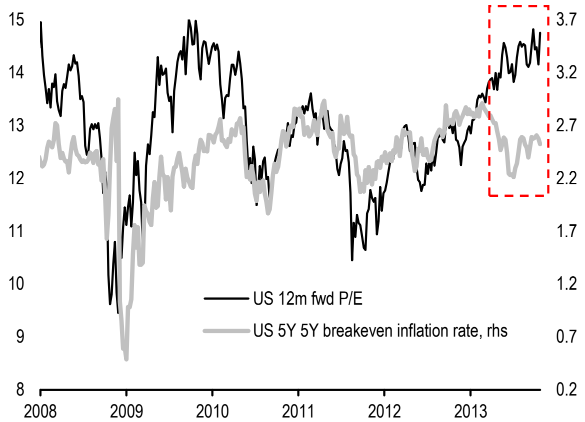
Fiscal policy: on balance, in Europe, the US and Japan, fiscal policy in 2014 looks likely to be easier than we would have expected. In Europe, we expect governments will be allowed more time to hit their fiscal targets (as long as restructuring continues) and fiscal easing will add about 0.5% to GDP growth next year. In Japan, the supplementary budget is likely to offset most of the impact of the consumption tax hike and in the US, as discussed above, fiscal policy could add around 1¾% to GDP growth in 2014.

Looser monetary and looser fiscal policy are on balance positive for equities vis-a-vis bonds.

3) Inflation expectations are more likely to rise than fall

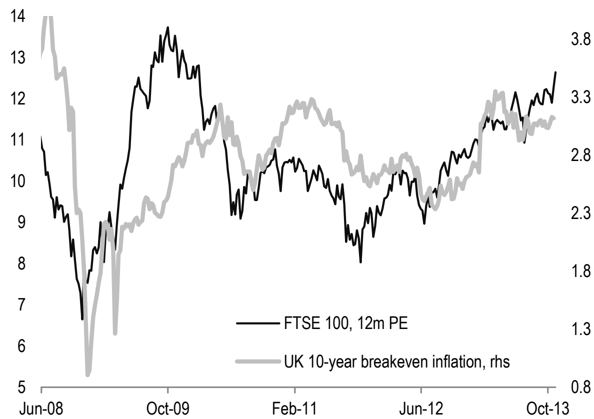
There is a close correlation between multiple and inflation expectations, and we believe that inflation expectations are likely to rise as a result of continued monetary policy proactivity.

Figure 24: **When US inflation expectations rise, so typically do P/E ratios.**



Source: Thomson Reuters, Credit Suisse research

Figure 25: **…with the same true in the UK**



Source: Thomson Reuters, Credit Suisse research

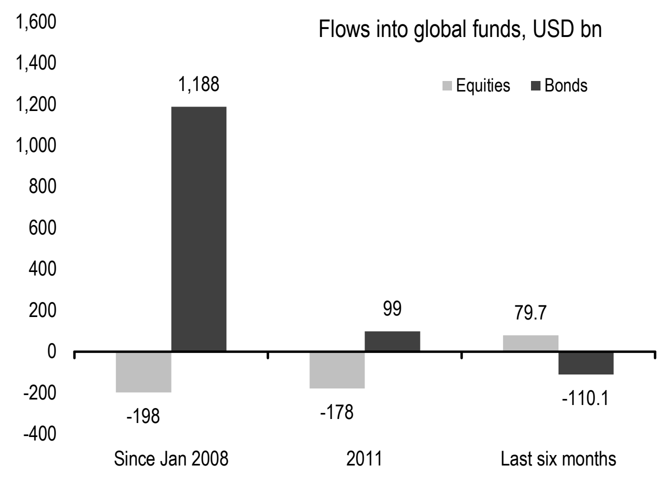
The risk we see is that the rise in bond yields is led by a rise in inflation expectations. We think that inflation expectations are likely to rise as it becomes apparent that, as above, fiscal and monetary policy into a recovery remain looser than many investors had expected. We would note for example the recent mismatch between inflation expectations in the bond market and consumer expectations of inflation in the UK: on a recent YouGov poll, UK consumer expectations of inflation jumped to 3.2% from 2.5%

As we show in Appendix 1, equities do not tend to de-rate until inflation expectations rise above 4%.

4) Long-term positioning remains fundamentally cautious

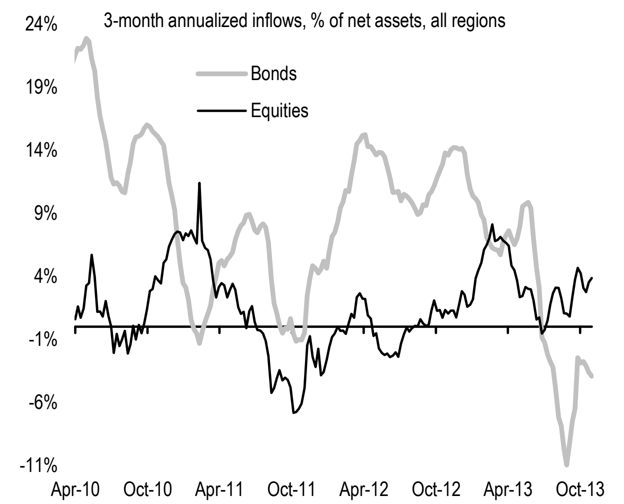
Since 2008, retail funds and institutions have sold nearly $200bn of equities (via cash, futures and ETFs). Retail buying shows signs of picking up as we see clear examples of a bond for equity switch (which has admittedly slowed down in the past quarter)

Figure 26: Since 2008, bond funds have seen around $1,188bn of inflows, while equity funds have experienced about $200bn of outflows



Source: Thomson Reuters, EPFR Global, Credit Suisse research

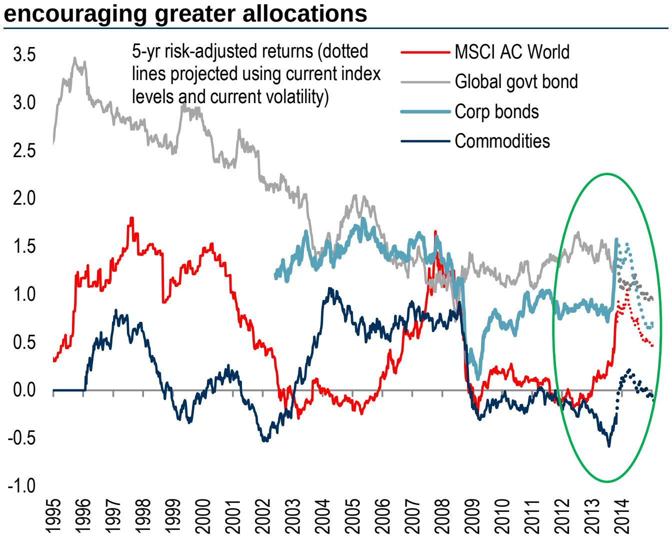
Figure 27: Inflows into equity funds are close to an eight-month high, while bond funds are experiencing outflows



Source: Thomson Reuters, EPFR Global, Credit Suisse research

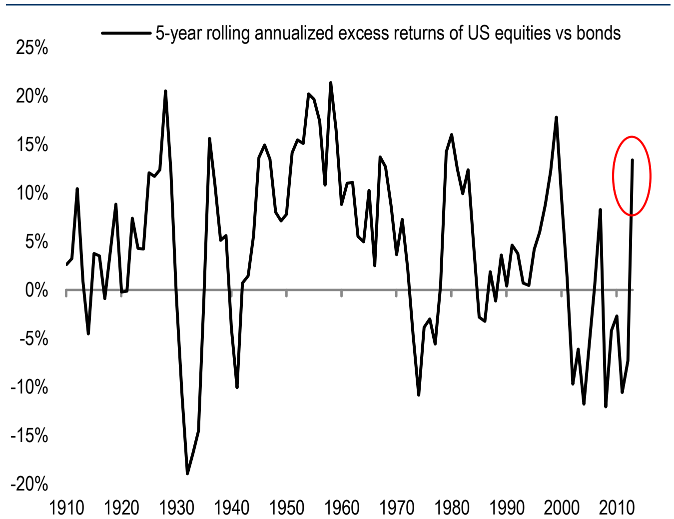
We may be cynical, but we believe that returns drive flows and by March 2014, the 5-year rolling risk-adjusted return for equities will rise to just over 1. This would be the highest since 2008 and, more importantly, a level close to that of government bonds. This may persuade actuaries to advise institutions to increase allocations towards equities. Moreover, over the past five years, equities have outperformed bonds by 13% a year.

Figure 28: Trailing risk-adjusted returns for equities are set to spike to be similar to bonds by Q1 2014, potentially encouraging greater allocations



Source: Thomson Reuters, Credit Suisse research

Figure 29: The 5-year rolling annualised excess return of equities over bonds is now over 13%



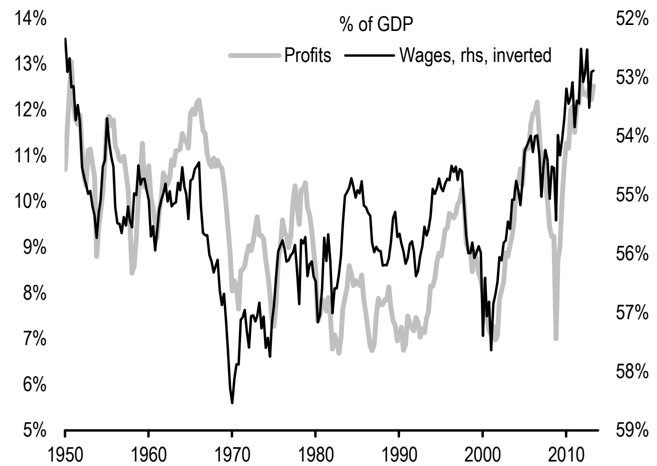
Source: Thomson Reuters, Credit Suisse research

In addition, we continue to believe that the corporate sector can increase leverage further to buy back more shares. We calculate that if those companies with leverage below the 20-year market average returned to average leverage levels, then the US and European corporate sector could buy $1.5trn and $650bn of equity respectively.

5) Margins remain well supported

We continue to believe that margins will peak roughly a year after labour has pricing power and thus in the US, the market peak is likely to be a mid-2016 event. Historically, margins have not peaked until hourly wage growth is between 3.5% and 4%, but currently it is just 2.2% (and growth in the wage component of the ECI has remained steady between 1½% and 2% for the past year). Moreover, equities have tended to peak 1 to 1½ years after the margin peak. This would point to an ultimate peak in markets in 2017.

Figure 30: Profit share of GDP and wage share move in opposite directions...



Source: Thomson Reuters, Credit Suisse research

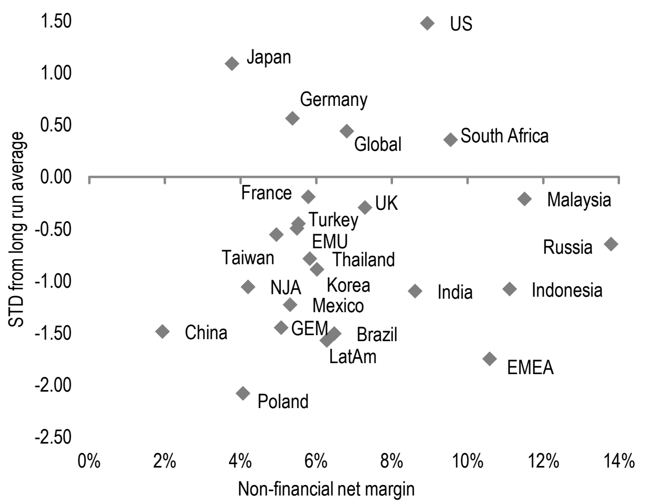
Figure 31: ... and margins only tend to peak 20 months after wage growth has picked up

Peak in US margin	US hourly wage growth, yoy	Trough in wage growth	Lag (mm)
Jun-84	3.5%	Aug-83	10
Dec-88	3.5%	Dec-86	24
Sep-97	3.9%	Mar-96	18
Sep-06	4.1%	Feb-04	31
Average	3.7%		21
Current	2.2%		

Source: Thomson Reuters, Credit Suisse research

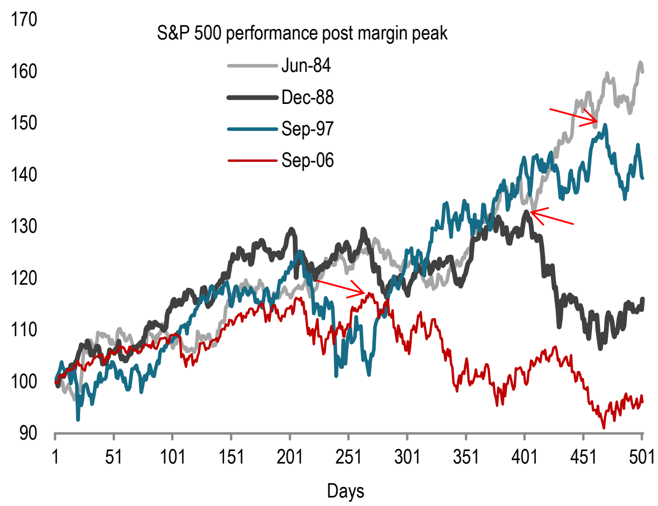
Outside of the US, margins are not high.

Figure 32: US margins are increasingly an outlier globally, both relative to other markets and relative to history



Source: Thomson Reuters, Credit Suisse research

Figure 33: US equities typically peak 12 to 18 months after the peak in margins



Source: Thomson Reuters, Credit Suisse research

6) EPS growth expectations remain reasonable

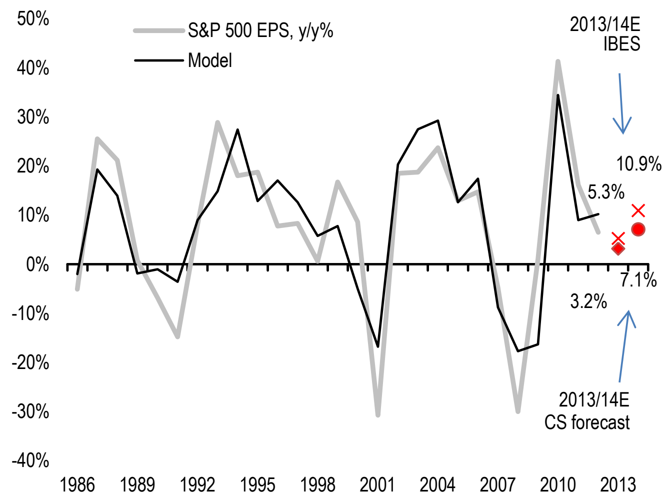
We revise up modestly our 2014 earnings growth forecasts for the US and Europe. In the US we now forecast EPS growth of 7.1%, up from 6.8%, and in the Euro area we forecast 10.5%, up from our previous estimate of 7.5%. We remain below consensus for both regions (IBES consensus forecast is 10.9% for the US and 15.4% for the Euro area).

Figure 34: **US earnings model specification**

Model inputs, % chg	Coeff.	*t-value*	2013E	2014E
US Real GDP	3.4	*3.0*	1.6%	2.6%
Non-fin. corporate GDP deflator	6.0	*2.6*	1.2%	1.6%
Total costs (ULC+NULC)*	-7.2	*-5.9*	1.0%	1.3%
USD trade-weighted	-0.4	*-1.5*	5.8%	5.0%
**ULC= Unit labour costs, NULC (nonlabor unit costs = 50% depr./10% interest/ 40% taxes)*				
Model output - S&P 500 operating EPS				
IBES consensus			*$108.6*	*$120.4*
Credit Suisse			*$106.4*	*$114.0*
IBES consensus			5.3%	10.9%
Credit Suisse			3.2%	7.1%
Model specifications				
RSQ	0.74			

Source: Thomson Reuters, Credit Suisse estimates

Figure 35: **Our US 2014 EPS growth forecasts is modestly below consensus (7.1% vs 10.9%)**



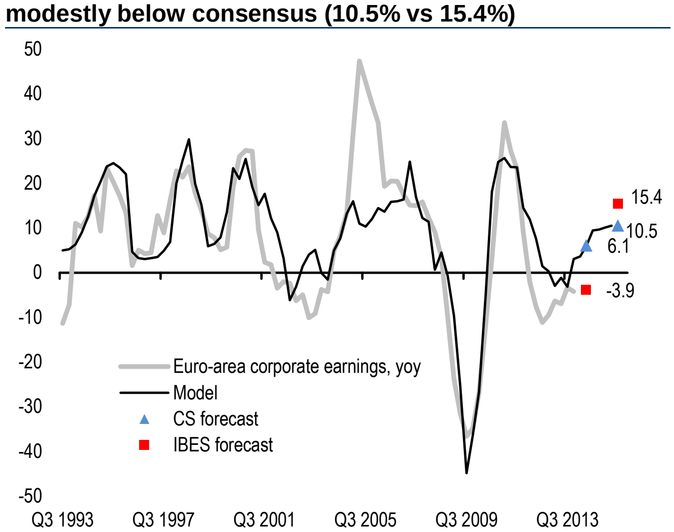
Source: Thomson Reuters, Credit Suisse estimates

Figure 36: **Euro area earnings model specification**

Expl. Variables:	Lead	Coeff.	Latest	2013E	2014E
Euro-area GDP yoy%	2Q	2.8	*-0.6*	*0.6*	*1.5*
Euro-area PPI yoy%	2Q	0.7	*0.3*	*0.4*	*1.1*
Euro-area unit labour costs yoy%	2Q	-6.6	*1.1*	*1.1*	*1.0*
Euro TWI yoy%	2Q	-0.1	*9.4*	*7.7*	*0.0*
Intercept		12.2			
R2		0.67			
MSCI EMU EPS, yoy				6.1%	10.5%
IBES Consensus				-3.9%	15.4%

Source: Thomson Reuters, Credit Suisse estimates

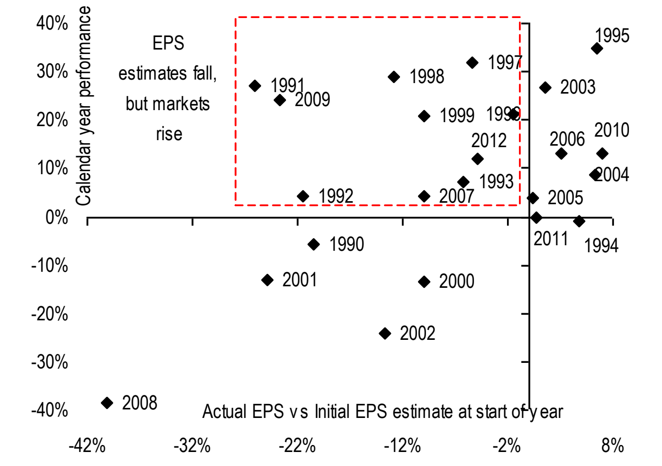
Figure 37: **Our Euro area 2014 EPS growth forecasts is modestly below consensus (10.5% vs 15.4%)**



Source: Thomson Reuters, Credit Suisse estimates

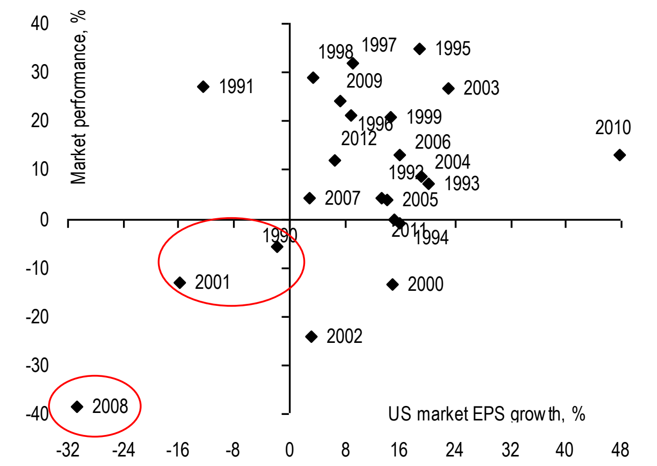
Although we are below consensus for 2014 earnings growth, even when earnings estimates are revised down, markets can rise significantly. History suggests that 66% of the time that earnings are revised down, markets have risen. It is when earnings contract by more than 5% that equity markets have sold off significantly (as was the case in 2001 and 2008).

Figure 38: **Even when earnings are revised down, markets can rise**



Source: Thomson Reuters, Credit Suisse research

Figure 39: **Historically, even fairly modest earnings growth has coincided with strong price gains**



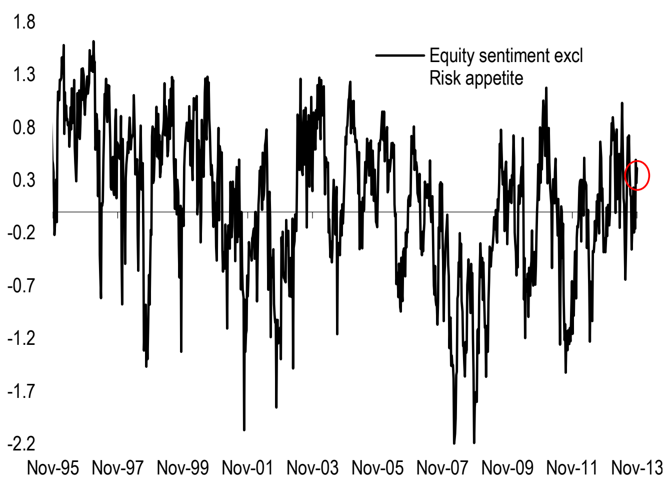
Source: Thomson Reuters, Credit Suisse research

7) Not all the tactical indicators are suggesting consolidation

As above, overall equity sector risk appetite may be very high, but overall risk appetite is neutral. This suggests that the pro-cyclical trade is much more advanced within equities than in terms of asset allocation.

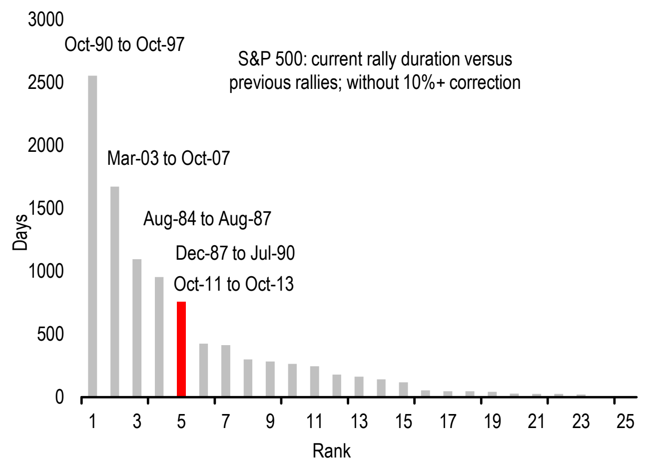
Our overall equity sentiment indicator (based on bullish sentiment, put/call ratio, inflows into equity funds and slope of implied volatility skew) is just 0.4 standard deviation above average.

Figure 40: **Our equity sentiment indicator is 0.4 standard deviation above average**



Source: Thomson Reuters, Credit Suisse research

Figure 41: **A rally in equities without a correction of 10% or more can last for up to seven years (on our data since 1980), compared to just two years so far**



Source: Thomson Reuters, Credit Suisse research

In addition, the US equity market can rally for very long periods without a correction of 10% or more: in the mid-2000s, it was 4½ years; in the 1990s, 7 years; and in the 1980s, equities rallied for two 2½-year periods without a large correction.

8) Credit spreads set to remain tight and credit marginally leads equities

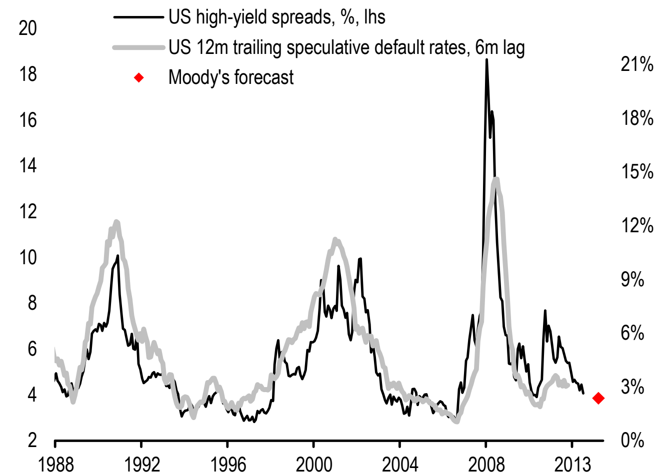
Equities and high yield spreads move together and high yield spreads in the US are only in line with current default rates.

Figure 42: Credit spreads have tended to widen three months prior to the peak in equity markets

	Equity market peak	US high yield credit spread low	Credit lead (-) / lag (+), mth
major peaks	25/08/1987	15/10/1987	1.7
	16/07/1990	20/03/1989	-16.1
	17/07/1998	29/04/1998	-2.6
	24/03/2000	28/12/1999	-2.9
	09/10/2007	12/06/2007	-4.0
		median	-2.9

Source: Thomson Reuters, Credit Suisse research

Figure 43: Moody's projections of speculative default rates are consistent with spreads if anything marginally falling



Source: Thomson Reuters, Credit Suisse research

What could trigger a correction?

Overall, we continue to believe that equities would have a meaningful correction (i.e. 10% or more) only after one of the following events occurs:

(1) There is a clear monetary shock with interest rates rising: we think this is likely to be a mid-2015 event in the US;

(2) Equities become clearly expensive against bonds (i.e. the US 10-year bond yield rises above 3½%);

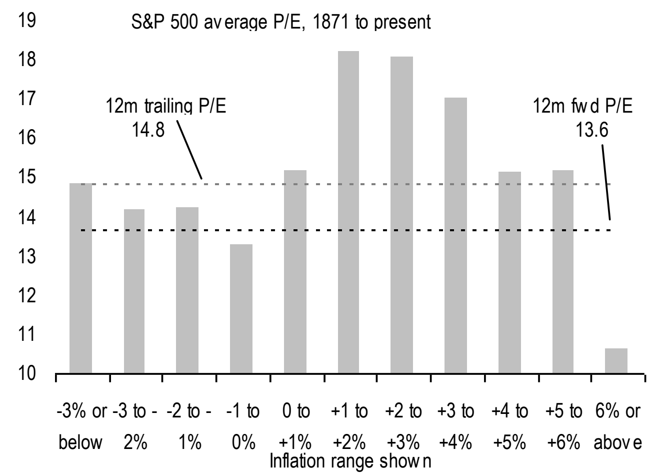
(3) Risk appetite indicators hit euphoria;

(4) A global macro shock (the most likely candidates being a sharper-than-expected slowdown in China or political shocks in peripheral Europe).

Appendix

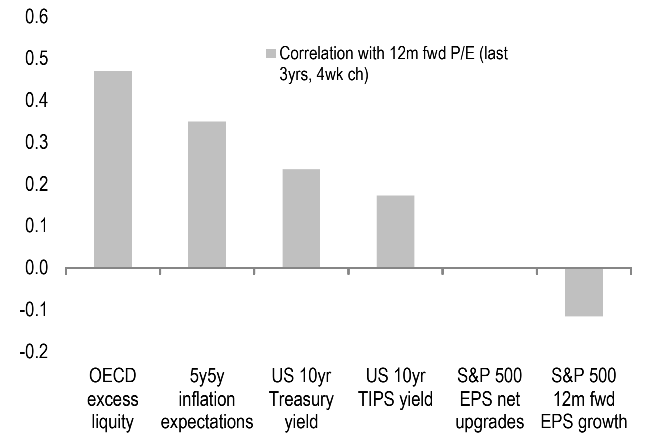
Appendix 1 – Key drivers of multiples

Figure 44: **Equities do not tend to de-rate significantly until inflation expectations rise above 4%...**



Source: Thomson Reuters, Credit Suisse research

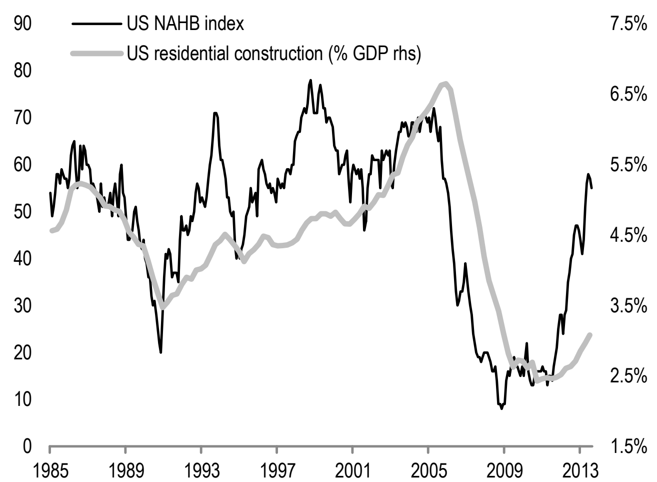
Figure 45: **…and inflation expectations are one of the primary drivers of the equity multiple**



Source: Thomson Reuters, Credit Suisse research

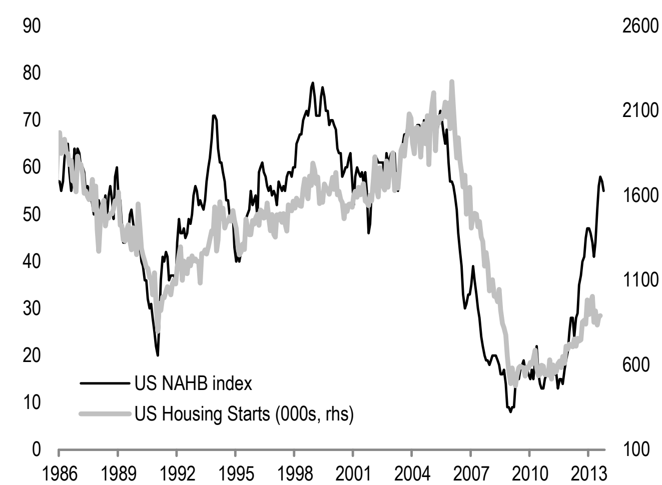
Appendix 2 – US housing

Figure 46: **The NAHB is consistent with construction rising close to 5% of GDP from its current 3%**



Source: Thomson Reuters, Credit Suisse research

Figure 47: **…and is consistent with a substantial rise in housing starts**



Source: Thomson Reuters, Credit Suisse research

Appendix 3 – Corporate net buying back test

Figure 48: S&P 500 price performance on previous occasions when the US corporate net buying fell from 3% of market cap to zero

Date when corp net buying fell to current level	S&P 500 perf since corp net buying fell to current Level 2-week	1-month	2-month	3-month	Maximum correction within 3 months
Aug-99	2%	2%	-1%	5%	-6%
Aug-00	2%	-2%	-10%	-8%	-11%
Feb-01	-5%	-12%	-8%	-1%	-15%
Oct-01	1%	4%	4%	3%	-4%
Sep-02	-7%	-6%	-1%	0%	-13%
Mar-04	3%	2%	-2%	2%	-2%
Oct-04	2%	7%	9%	7%	-1%
Jan-05	3%	3%	0%	-1%	-3%
Apr-06	2%	0%	-4%	-4%	-5%
Oct-07	-3%	-5%	-1%	-12%	-13%
Mar-08	3%	5%	4%	-4%	-3%
Oct-08	1%	-8%	-8%	-10%	-20%
Mar-09	15%	23%	33%	38%	-1%
Dec-09	0%	1%	-1%	4%	-4%
Apr-10	0%	-6%	-10%	-12%	-16%
Sep-10	3%	4%	4%	10%	0%
Mar-11	2%	2%	1%	-3%	-3%
Mar-12	-1%	0%	-6%	-3%	-9%
Dec-12	0%	4%	7%	10%	-1%
Average (excl Mar 09)	**0.3%**	**-0.2%**	**-1.3%**	**-1.0%**	**-7.3%**
Average (inc Mar 09)	**1.1%**	**1.0%**	**0.5%**	**1.0%**	**-6.9%**
Median	**1.6%**	**1.8%**	**-1.0%**	**-0.7%**	**-4.1%**
Typical	**0.1%**	**0.5%**	**0.9%**	**1.3%**	
% fall	**63%**	**68%**	**42%**	**42%**	

Source: Trim Tabs, Thomson Reuters, Credit Suisse research

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