



MACRO HIGHLIGHTS & STRATEGY

WEEK OF 9 MAY 2016

OUR ROUNDUP:

- ▶ **United States: Looking for a link between capital spending and profits**
 - We expect capex to decline significantly by the end of the year
 - Companies operating at maximum capacity will not necessarily show the strongest earnings growth
 - ▶ **Emerging Markets: Brazil - Are Rousseff's days in office numbered?**
 - The Senate is likely to suspend the president in its upcoming vote
 - Rousseff's removal would not guarantee that the country's economic fortunes will turn around or that domestic assets will continue to recover
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UNITED STATES

LOOKING FOR A LINK BETWEEN CAPITAL SPENDING AND PROFITS

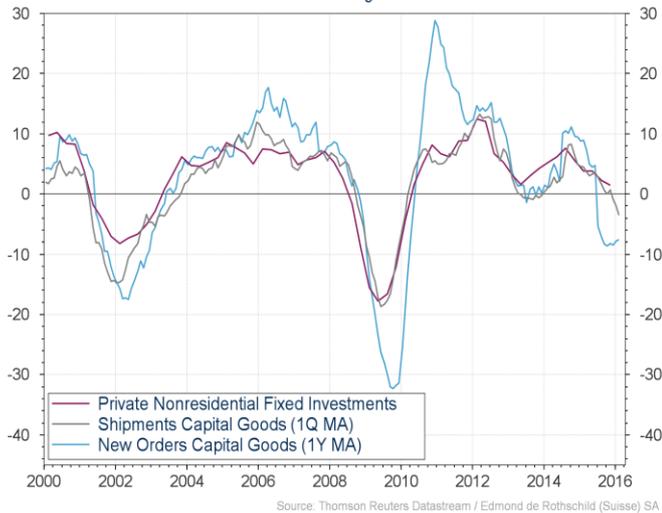
After analysing the latest data available, **we expect capital spending to decline significantly by the end of the year**. The sharpest decline should be in the area of non-residential investments, in other words business spending on factories and machinery. What factors affect capital spending? Is it possible to draw a link between low capacity utilisation and corporate earnings?

- The latest monthly data on orders and deliveries for capital goods came in ahead of expectations, **yet the full-year picture remains negative**. The downtrend (see left-hand chart below) points to weak growth in fixed investments by companies this year.
- **Stricter lending terms and rising salaries** – the inevitable result of an improving jobs market – will discourage spending on new projects. And as long as their return on investment is low, firms will maintain their preference for share buybacks.

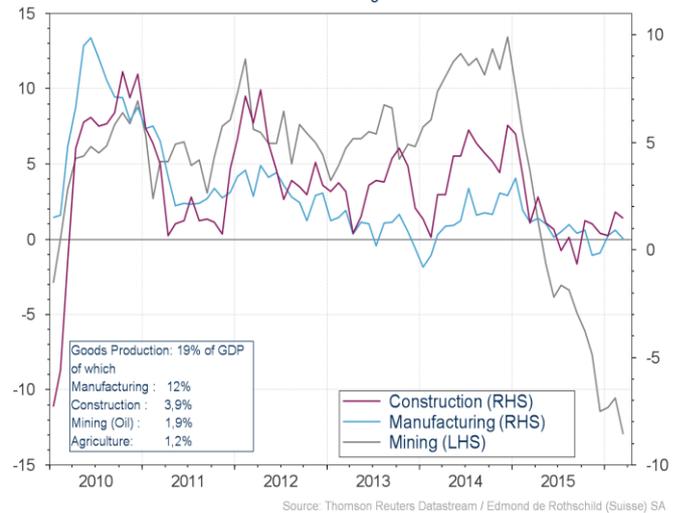


- **Industrial production continues to fall**, and is currently 2% lower than one year ago. It has three main components – construction, manufacturing and mining – the third of which is dragging the entire industry into recession (see right-hand chart below). As a result, rather than rushing to make capital investments, companies are trying first to get their existing production on track.

US: Fixed Investments & Capital Goods Orders/Shipments
YoY % Chg

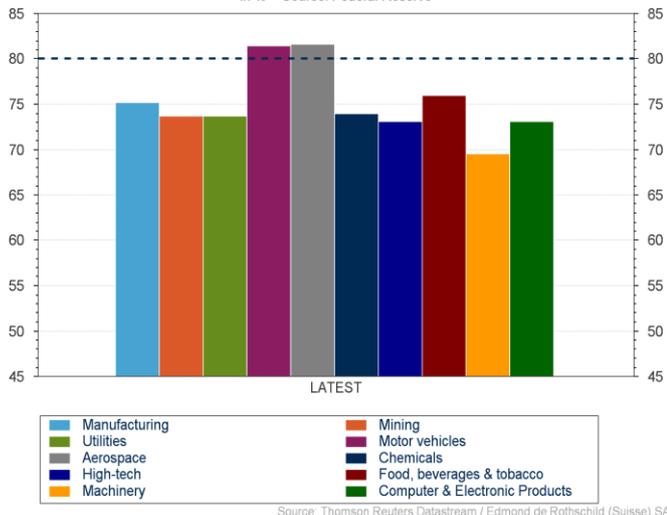


US: Industrial Production by Sector
YoY % Chg

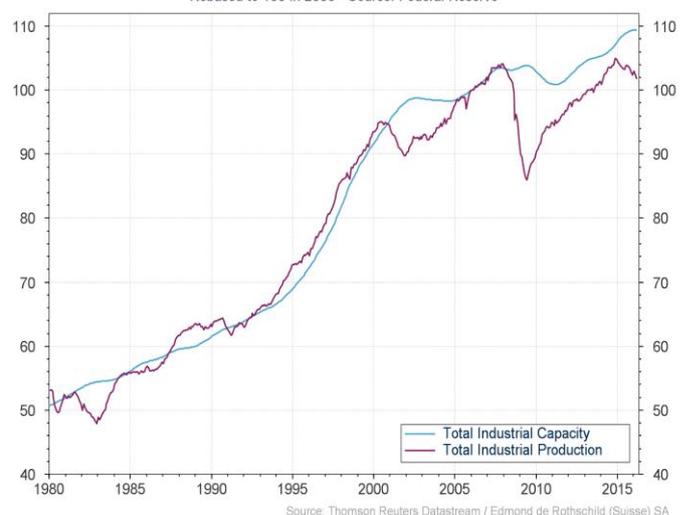


- Capital utilisation rates suggest that the problem is not limited to the oil industry but affects many other sectors too. **For most industrial segments, the capacity utilisation rate is below 80%** (see charts below), and this includes the mining, manufacturing, machinery and chemicals sectors. Only the automotive and aerospace sectors, which account for 10% of total production, fully use their productive capacity.

US: Capacity Utilisation per Sector
in % - Source: Federal Reserve

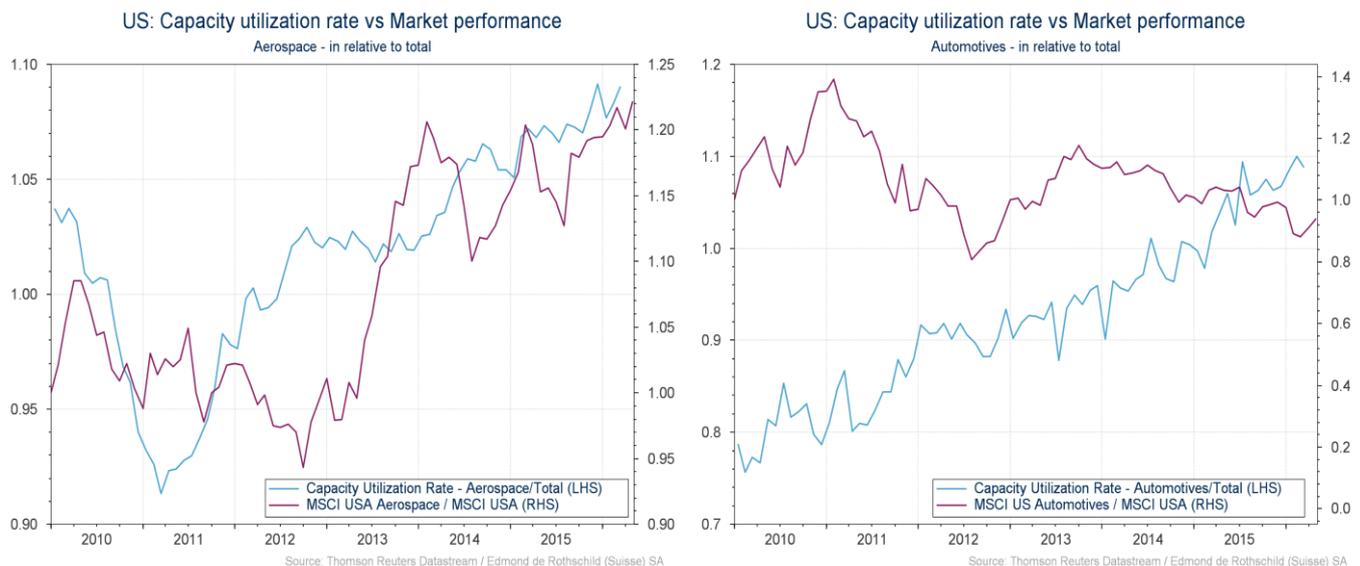


US: Capacity vs Industrial Production
Rebased to 100 in 2006 - Source: Federal Reserve





Does that mean these two sectors' market indexes have outperformed in recent years? Yes for aerospace (see left-hand chart), but no for automotive (see right-hand chart). Other microeconomic factors have to be taken into account when evaluating earnings. In 2015, for example, the automotive sector was hurt by its exposure to China, where growth slowed. Also, each sector has its own comfort zone when it comes to its capacity utilisation rate. Some industries are forced to invest in capital goods before reaching the 80% level. Finally, while capital spending pays off in the long term, it can take a bite out of profits in the short term.



But we cannot draw neat conclusions. **Companies operating at maximum production capacity will not necessarily show the strongest earnings growth.**

EMERGING MARKETS

BRAZIL - ARE ROUSSEFF'S DAYS IN OFFICE NUMBERED?

Every quarter, the Brazilian economy slips deeper into recession. And since the end of 2014, it has been further burdened by a political crisis that worsens by the day. The table below summarises the country's recent political turbulence.

- ▶ **As of today, the most plausible scenario is that the Senate will suspend Rousseff, allowing the impeachment proceedings to move forward.** The latest surveys indicate that 50 senators are in favour of impeaching the president. The fact that the Senate is dominated by the Brazilian Democratic Movement Party (PMDB), which recently broke with the president's coalition, does not



bode well for Rousseff. The current vice president of Brazil, Michel Temer, is the PMDB's leader in waiting and would serve as president until the 2018 elections.

Date	Key event
2 December 2015	The Chamber of Deputies approved an impeachment request based on accusations that the president manipulated the country's fiscal accounts.
Mid-December 2015	The Chamber of Deputies created a 65-member impeachment committee whose task was to examine the allegations and issue an opinion.
29 March 2016	The PMDB, which was the main ally of Rousseff's party (PT), joined the opposition.
11 April 2016	The committee voted 38-27 in favour of impeachment proceedings.
17 April 2016	The Chamber of Deputies followed the committee's lead, voting 367 to 137 to open impeachment proceedings. The impeachment process then went to the Senate.
25 April 2016	The Senate formed a 21-member impeachment committee tasked with making its own recommendation.
6 May 2016	The Senate committee voted 15 to 5 in favour of moving forward with the impeachment proceedings and putting Rousseff on trial.
11-13 May 2016*	<p>The Senate is to decide, by simple majority, on whether to suspend the president and put her on trial. For this to happen, 41 of the 81 senators would have to approve.</p> <ul style="list-style-type: none"> - If they do, the president would be suspended for up to 180 days. Vice President Michel Temer, the PMDB leader in waiting, would serve as interim president. - If the trial is not resolved within 180 days, Rousseff would return to power until the end of her term.
July-August 2016*	The Senate could hold impeachment hearings and make a decision. A two-thirds majority (54 out of 81) is needed to permanently remove Rousseff from office. Vice President Temer would then serve as president until the 2018 elections.

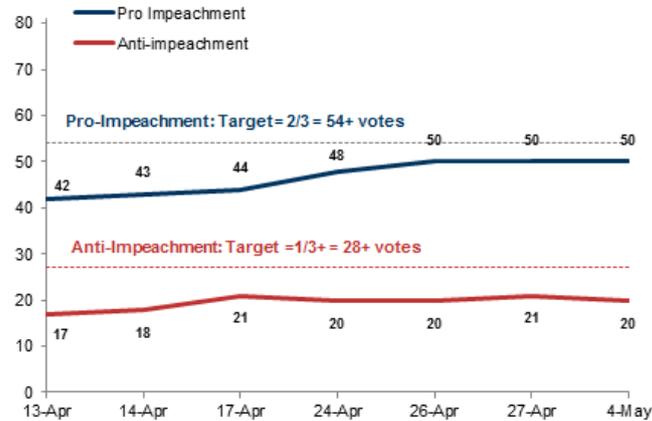
**Estimated dates*

Under this scenario, Temer himself could also be exposed to impeachment proceedings. Not only is Temer not popular among the people, but he is also in the Supreme Court's crosshairs. It has asked the Chamber of Deputies to look into allegations that Temer too was involved in manipulating the country's fiscal accounts – the same charge levied against Rousseff. If he were impeached before 1 January 2017, early elections would be held to elect a new president. After 1 January 2017, Congress would be responsible for electing a new president.

An early popular vote would not be to the PMDB's advantage: voting intentions point to a victory for former President Lula, who is from the same party as Rousseff and is known as the man behind Brazil's economic boom in the last decade. In addition, impeachment proceedings against Temer would be likely to fail, since he and the speaker of the Senate are from the same party.



How the Senate is likely to vote in an impeachment trial



Note: The impeachment will succeed if at least 54 Senators vote in favor (2/3 of total seats). The impeachment will fail if at least 28 Senators vote against, are absent and/or do not vote (1/3+ of total seats)

Source: Estadão

- ▶ If the Senate votes against holding impeachment proceedings, Rousseff will remain in power. If this were to happen, the disconnect between the political establishment and its electoral base could very easily worsen, with suspicions of back-room bargaining and political deals further undermining Rousseff's legitimacy at the helm of the government.
- ▶ Impeachment is not the only way out of the current political stalemate. Rousseff could simply resign. But she has repeatedly ruled out this option, which for her would be tantamount to admitting guilt and handing the opposition a victory. Another possibility would be for the Electoral Court to annul the 2014 election for financing irregularities. This would lead to early legislative elections.

Brazil is a complex equation. Improving the country's current account seems to require a weak currency. And greater economic stability will require the political will to enact – and implement – structural reforms. But will the Brazilian political system allow for this sort of reasoned approach to the problem? A number of obstacles seem to stand in the way of a unified and long-term reform agenda: fragmentation across the political spectrum (23 parties are represented in Congress) whose roots lie in the country's federal structure; politicians' weak party loyalty; and the sometimes hazy role played by businesses in party financing.

There are countless political scenarios, which makes forecasting a challenge. The legal charges hanging over those who could take over for Rousseff only add to the confusion, and there is no guarantee that a change in president will lead to any real break from past practices or fundamentally improve the country's economic situation. That said, Rousseff's impeachment would probably close the gap between politicians and the citizen base ever so slightly. **Investors appear to expect impeachment to occur followed by a popular election – a scenario we consider far from certain – which would allow Brazilian assets, including the currency, to continue their rebound.**



ECONOMIC FORECASTS

Contributions to global GDP growth

Economic Activity	GDP 2015	GDP 2016 Economist Estimates	GDP 2017 Economist Estimates	Country Weights	Contribution 2016
United States	2.4%	↓ 1.9%	→ 2.3%	23.6%	14.2%
Canada	1.2%	↑ 1.6%	↑ 2.2%	1.9%	0.9%
Euro Area	1.5%	→ 1.5%	→ 1.6%	14.5%	6.9%
Germany	1.5%	→ 1.5%	→ 1.6%	4.2%	2.0%
France	1.1%	↓ 1.3%	↓ 1.4%	2.9%	1.2%
United Kingdom	2.2%	↓ 1.9%	↓ 2.1%	3.5%	2.1%
Switzerland	0.8%	→ 1.2%	→ 1.6%	0.7%	0.3%
Russia	-3.7%	→ -1.5%	→ 1.2%	1.6%	-0.8%
Japan	0.6%	↓ 0.5%	↓ 0.5%	5.1%	0.8%
China	6.9%	→ 6.5%	→ 6.3%	18.4%	37.9%
India	7.4%	→ 7.5%	↓ 7.6%	3.4%	8.2%
Brazil	-3.7%	↓ -3.7%	↓ 1.0%	1.9%	-2.2%
Mexico	2.5%	↑ 2.5%	↓ 2.8%	1.5%	1.2%
Others	3.8%	5.2%	6.0%	16.7%	27.4%
WORLD	3.1%	3.2%	3.5%	100%	100%

Source : Bloomberg

Momentum (vs Last Estimates)

Performance (Over \ Under)

Comments

- ▶ The GDP growth rates shown above are actual for 2015 and projections for 2016 and 2017.
- ▶ Each country's weighting is based on its GDP in US dollars as calculated by the World Bank.
- ▶ Contributions to global expansion are calculated by multiplying the GDP growth of each country by its weight. The sum of the contributions works out to 3.2% for 2016, a good estimate of this year's global GDP growth.



RETURNS ON FINANCIAL ASSETS

Major benchmarks and currencies

Markets Performances (local currencies)	Last Price	1-Week (%)	1-Month (%)	Year-to-Date (%)	Last Year (%)
Equities					
World (MSCI)	396	↓ -1.8%	↓ 0.8%	0.1%	-1.8%
United States (S&P 500)	2'063	↓ -0.3%	↓ -0.3%	1.4%	1.4%
Euro Area (DJ EuroStoxx)	318	↓ -2.1%	↑ 2.1%	-7.2%	11.2%
United Kingdom (FTSE 100)	6'134	↓ -1.8%	↓ -0.2%	-0.3%	-1.4%
Switzerland (SMI)	7'834	↓ -2.8%	↑ 0.8%	-9.7%	1.1%
Japan (NIKKEI)	16'216	↓ -3.4%	↑ 2.5%	-14.7%	11.0%
Emerging (MSCI)	805	↓ -4.1%	↓ -0.3%	1.9%	-14.6%
Bonds (Bloomberg/EFFAS)					
United States (7-10 Yr)	1.76%	↑ 0.5%	↓ 0.0%	4.9%	2.1%
Euro Area (7-10 Yr)	1.23%	↑ 0.8%	↓ -0.3%	3.9%	1.0%
Germany (7-10 Yr)	0.14%	↑ 1.1%	↓ -0.1%	5.0%	0.9%
United Kingdom (7-10 Yr)	1.42%	↑ 1.3%	↓ -0.1%	4.7%	0.7%
Switzerland (7-10 Yr)	-0.30%	↑ 0.4%	↓ -0.6%	2.3%	3.7%
Japan (7-10 Yr)	-0.10%	↑ 0.4%	↑ 0.4%	3.3%	1.4%
Emerging (5-10 Yr)	4.97%	↓ -0.4%	↓ 0.7%	5.9%	1.6%
United States (IG Corp.)	3.02%	↓ 0.2%	↓ 1.2%	5.5%	-0.8%
Euro Area (IG Corp.)	0.79%	↑ 0.4%	↓ 0.2%	3.2%	-0.5%
Emerging (IG Corp.)	3.96%	↓ -0.1%	↓ 1.5%	6.0%	-2.3%
United States (HY Corp.)	7.68%	↓ -0.7%	↓ 3.0%	7.0%	-3.5%
Euro Area (HY Corp.)	4.39%	↓ -0.5%	↓ 1.1%	3.3%	0.3%
Emerging (HY Corp.)	8.91%	↓ -0.3%	↑ 3.1%	8.5%	3.6%
United States (Convert. Barclays)	43	↓ -1.3%	↓ -0.4%	0.1%	-0.8%
Euro Area (Convert. Exane)	7'166	↓ -0.4%	↓ 0.4%	-4.4%	7.6%
Real Estate					
World (MSCI)	199	↑ 1.0%	↓ 1.8%	6.0%	1.0%
United States (MSCI)	212	↑ 3.9%	↓ 1.9%	6.8%	4.6%
Euro Area (MSCI)	216	↓ 0.3%	↓ -1.5%	4.2%	16.1%
United Kingdom (FTSE)	6'679	↓ 0.1%	↑ 0.8%	1.3%	9.4%
Switzerland (DBRB)	3'754	↓ -2.4%	↓ 0.4%	3.9%	4.6%
Japan (MSCI)	253	↓ -2.7%	↑ -0.1%	-5.7%	0.9%
Emerging (MSCI)	97	↓ -5.3%	↓ -0.6%	-2.4%	-6.8%
Hedge Funds (Dow Jones)					
Hedge Funds Industry	538	n.a.	↑ 0.3%	-2.2%	-0.7%
Distressed	713	n.a.	↑ 0.6%	-1.9%	-5.3%
Event Driven	566	n.a.	↑ 0.3%	-4.5%	-6.3%
Fixed Income	299	n.a.	↑ 0.6%	-1.2%	0.6%
Global Macro	865	n.a.	↑ -0.1%	-2.2%	0.2%
Long/Short	651	n.a.	↑ 0.7%	-3.8%	3.6%
Managed Futures (CTA's)	330	n.a.	↓ -2.8%	4.4%	-0.9%
Market Neutral	268	n.a.	↑ 1.6%	-0.4%	1.7%
Multi-Strategy	518	n.a.	↑ 0.7%	-0.6%	3.8%
Short Bias	31	n.a.	↓ -6.6%	-0.9%	2.4%
Commodities					
Commodities (CRB)	402	↓ -1.0%	↑ 6.8%	6.8%	-15.2%
Gold (Troy Ounce)	1'265	↓ -2.2%	↓ 0.6%	19.1%	-10.6%
Oil (Brent, Barrel)	44	↓ -3.3%	↑ 15.3%	25.4%	-35.9%
Currencies					
USD	94.1	↑ 1.6%	↑ -0.1%	-4.5%	9.3%
EUR	1.14	↓ -1.2%	↓ -0.1%	4.9%	-10.2%
GBP	1.44	↓ -1.9%	↑ 1.1%	-2.3%	-5.4%
CHF	0.97	↓ -1.7%	↓ -1.7%	3.2%	-0.8%
JPY	108.5	↓ -2.0%	↓ -0.6%	10.8%	-0.4%

Source : Bloomberg

↑ ↓ Momentum (1-week / 1-month / 3-month)

Performance (Negative \ Positive)



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