

ANDBANK RESEARCH

Global Economics &
Markets

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Working paper - 48

... Ok but, how much is the S&P worth?

May 24th , 2013

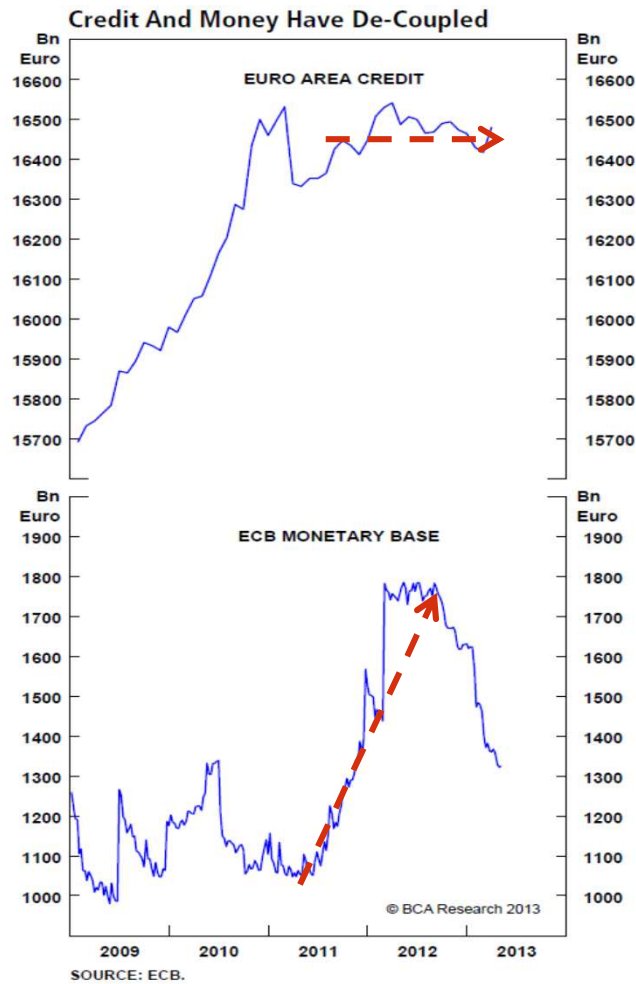
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This has been the most complex analysis I have undertaken since, some years ago, I left the portfolio management activity to concentrate on the analysis activity.

This is probably because of all assets, equities are those in which the psychological component plays a more prominent role.

The conclusions of this analysis are the result of a thorough and lengthy discussion with our Equity Strategist, Mr J.A.Cerdan, a co-worker and despite this, a good friend.

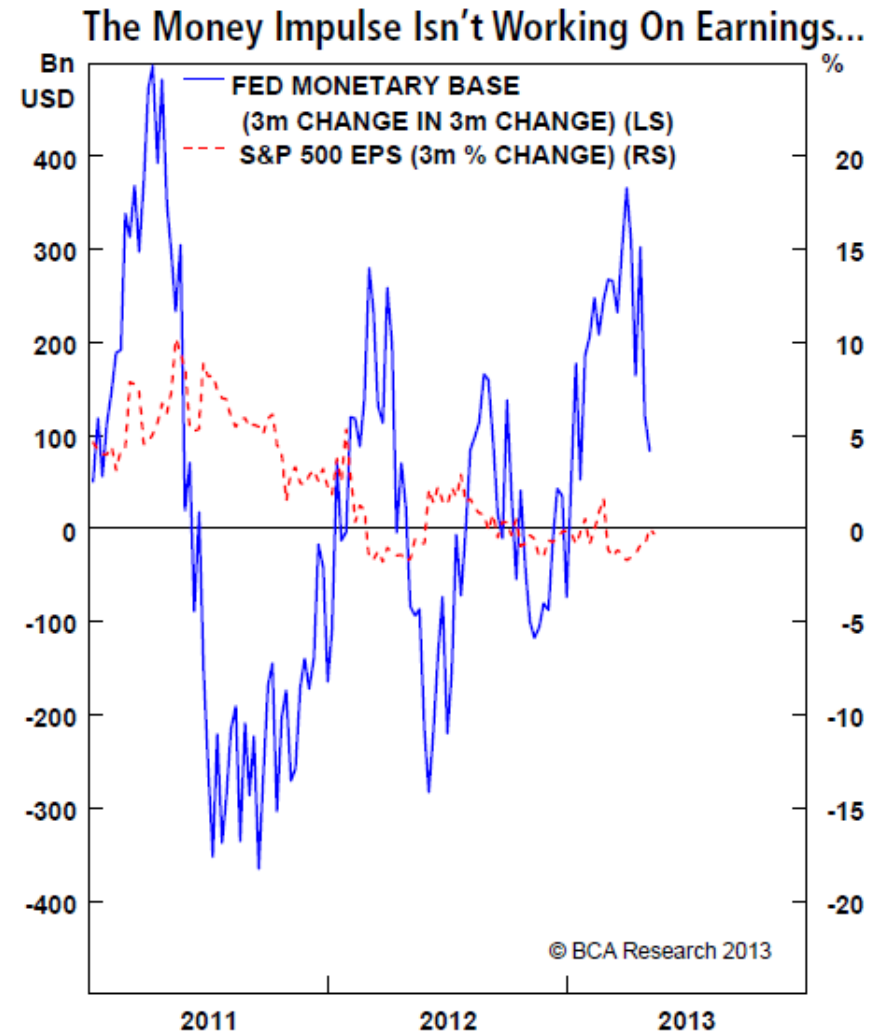
I guess that it will not catch you by surprise if I say that monetary expansion (QE) does not lead to an expansion in credit



... and, as there is no Credit cycle ...

... there is no economic cycle ...

... NOR CYCLE IN CORPORATE EARNINGS!

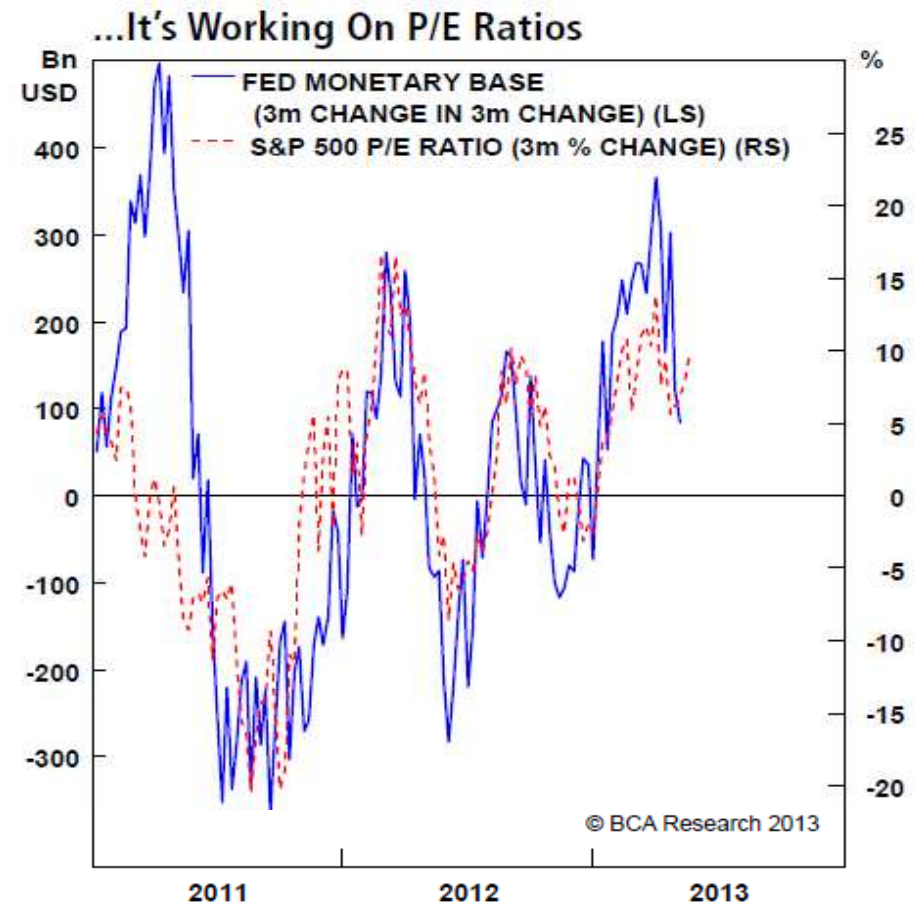


... what inevitably leads us to the conclusion (insistently defended) that the S&P performance has been a mere question of MULTIPLES!!

... a concept that has expanded at the same pace that monetary base.

At this point, everybody realizes that the million dollar question is:

What will be the medium - term Money Impulse?



SOURCES: THOMSON REUTERS AND THE FEDERAL RESERVE.

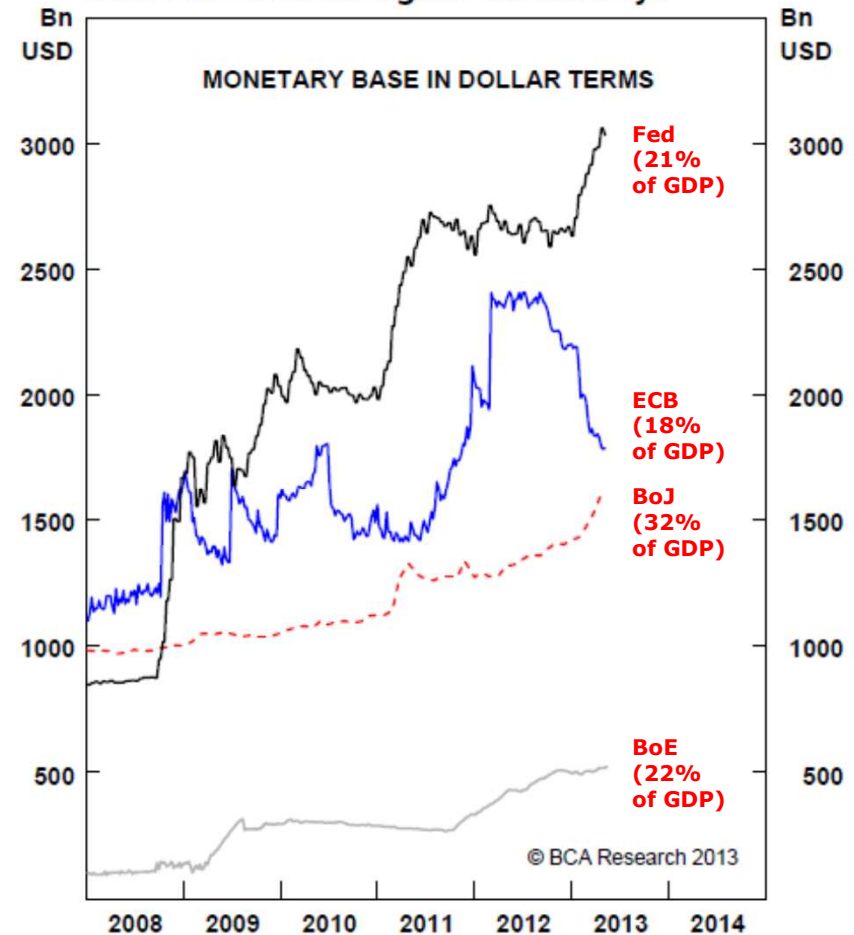
Let's go then with the million dollar question. What will be the medium - term money impulse?

According to our proxies to assess the intensity implemented in the QE program (these proxies are the Beveridge curve, the velocity of money and the risks assumed in Fed's balance-sheet) ...

... we can draw central and alternative scenarios for the future pace of Fed's QE and thus the future size of central bank's balance sheet.

This should help us to determine the evolution in PE multiples, and thus, keeping stable our estimates for EPS, derive the target value for the S&P.

Who's Been Creating All The Money?



U.S. DOLLAR TERMS (1.35 USD/EURO, 1.5 USD/GBP, 90 YEN/USD);
SOURCES: ECB, BOJ, BOE AND THE FEDERAL RESERVE.

1st Scenario: Fed continues expanding monetary base at a monthly pace of 85bn\$.

Report date: 23-MAY-2013

Legend

- USBC0065051 =
- USBC0065072 =
- USBC0064693 =
- FRBH41T2LNH@US =

Monthly Pace in QE 85

Dates	Monetary Base (bn \$)	3m Change	3m Change in 3m Change Money Impulse
26-dic-2013	3.684	255	0
26-nov-2013	3.599	255	0
27-oct-2013	3.514	255	0
27-sep-2013	3.429	255	10
28-ago-2013	3.344	255	9
29-jul-2013	3.259	255	-9
29-jun-2013	3.174	245	-12
30-may-2013	3.089	246	45
30-abr-2013	3.004	264	138
29-mar-2013	2.929	257	182
28-feb-2013	2.844	200	212
31-ene-2013	2.741	125	159
31-dic-2012	2.673	75	94

24% of GDP

Money Impulse (in bn \$US)

2nd Scenario: Fed continues expanding monetary base but at a gradually slower pace (reducing the pace of monthly purchases in 10bn each month)

Report date: 23-MAY-2013

Legend

- USBC0065051 =
- USBC0065072 =
- USBC0064693 =
- FRBH41T2LNH@US =

Monthly Pace in QE

-10

Dates	Monetary Base (bn \$)	QE implementation	3m Change	3m Change in 3m Change Money Impulse
26-dic-2013	3.404	15	75	-90
26-nov-2013	3.389	25	105	-90
27-oct-2013	3.364	35	135	-90
27-sep-2013	3.329	45	165	-70
28-ago-2013	3.284	55	195	-51
29-jul-2013	3.229	65	225	-39
29-jun-2013	3.164	75	235	-22
30-may-2013	3.089	85	246	45
30-abr-2013	3.004		264	138
29-mar-2013	2.929		257	182
28-feb-2013	2.844		200	212
31-ene-2013	2.741		125	159
31-dic-2012	2.673		75	94

22,6% of GDP

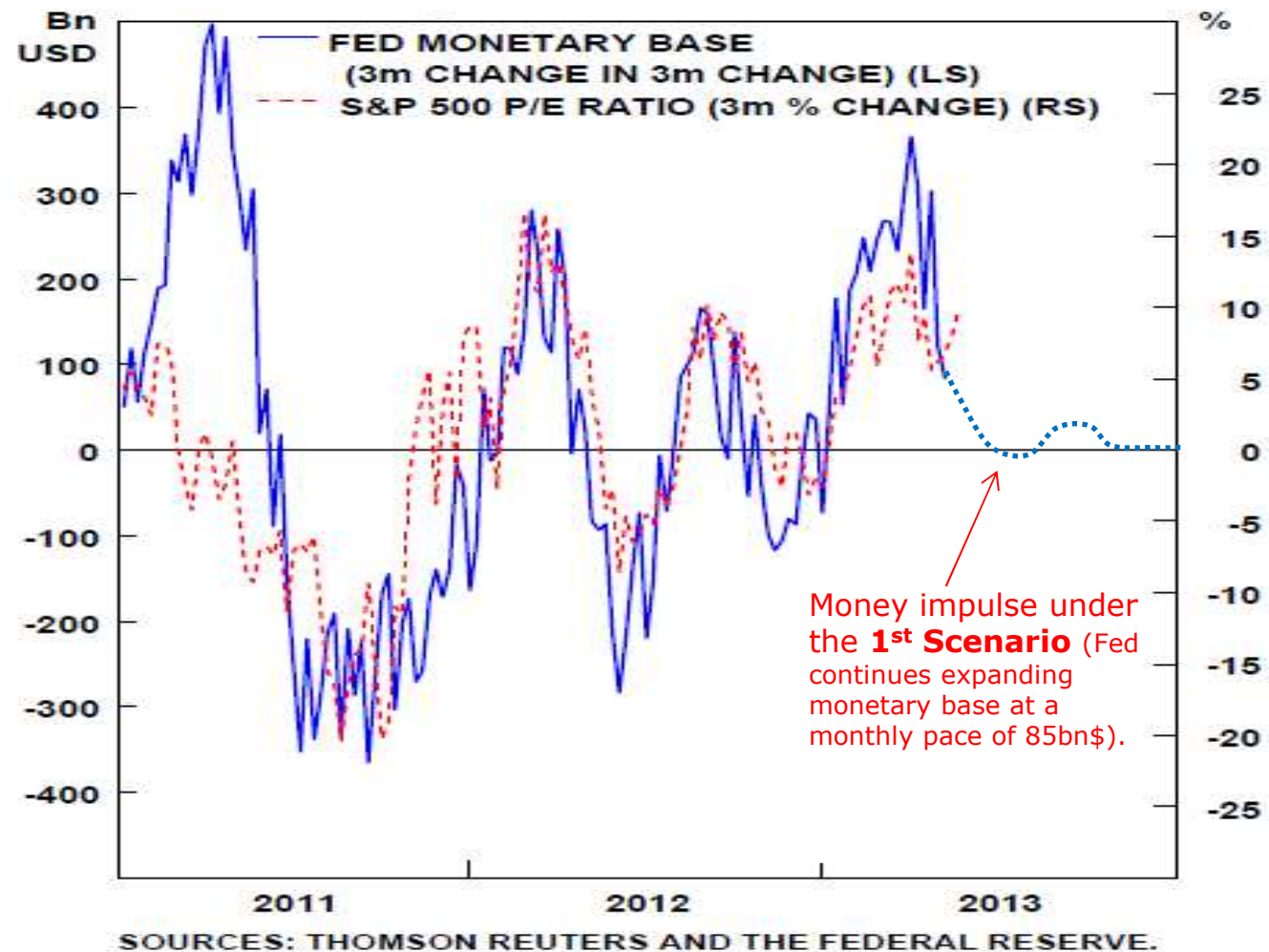
Money Impulse (in bn \$US)

Now let's plot the monetary impulse under the two scenarios. Let's go with the 1st scenario.

In such a scenario, the "money impulse" will follow the path suggested by the blue dotted line (projected by Andbank) ...

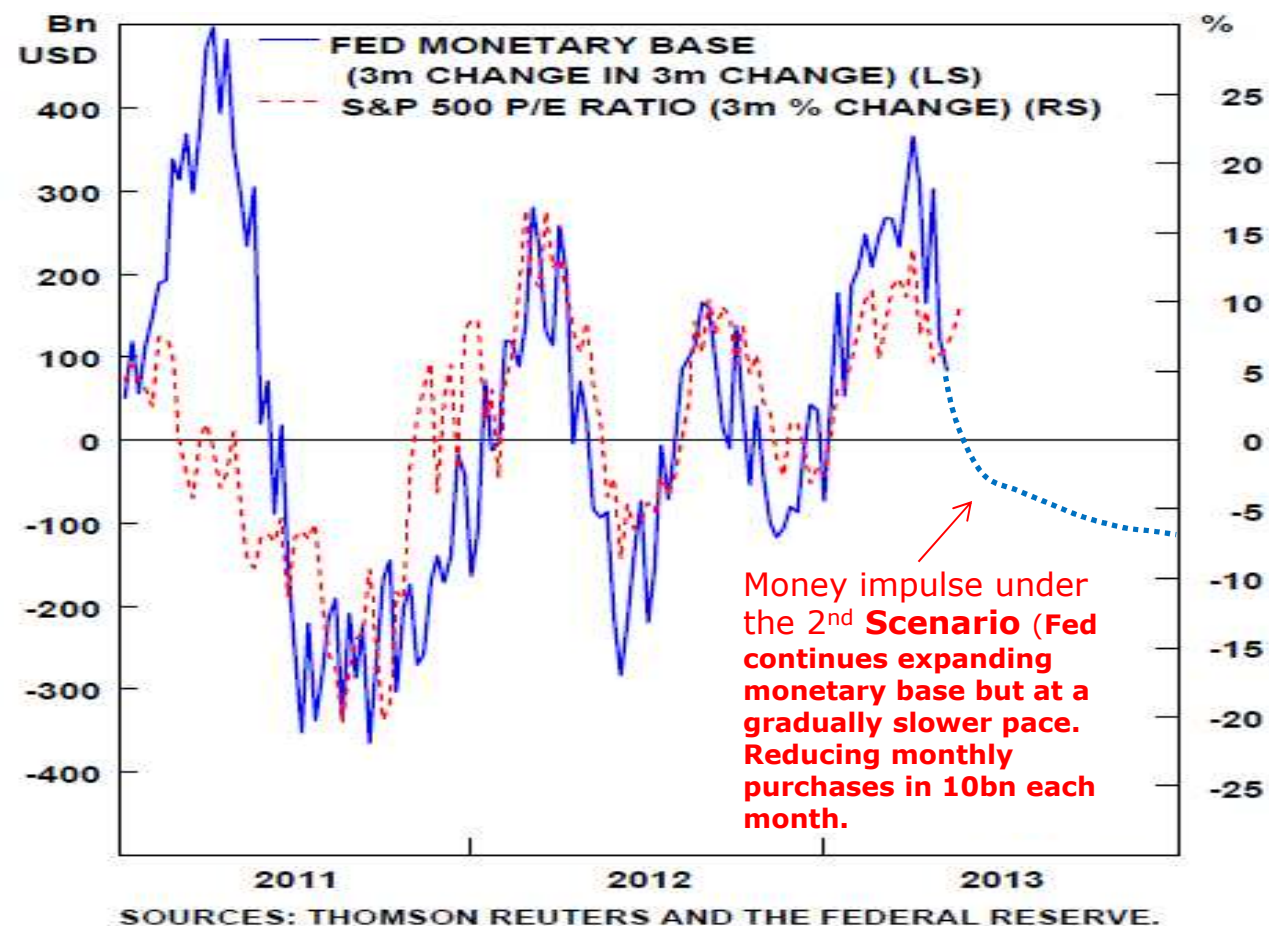
... and, as such, growth in PE multiple will follow a similar trajectory, that suggests ...

... a sharp reduction in PE growth in June (to experience a slight contraction in the 3Q) and stability in 4Q)



Now let's plot the monetary impulse under the two scenarios. Let's go with the 2nd scenario.

In such a scenario, the "money impulse" path suggested in the chart points to a continuous re-pricing of equities, in the sense that we could witness a 5% decline each month in the PE multiple of the S&P (relative to its previous 3 months value) starting this summer.



And now, the final step. Once we know what the money impulse will be, we can draw a picture for the % change in PE, and thus project the 2013 PE ratio (ltm) at December

1st Scenario: 85bn monthly in QE

	Money Impulse	PE ratio (3m% change)	PE 2013 Projected
February			14,15
March			14,15
April			14,51
May	45	2,3%	15,04
June	-12	-0,6%	14,07
July	-9	-0,5%	14,44
August	0	0,0%	15,04
September	10	0,5%	14,14
October	0	0,0%	14,44
November	0	0,0%	15,04
December	0	0,0%	14,14

This are the figures we must consider when assessing the fundamental value of the S&P

2nd Scenario: 10bn monthly slowdown in QE

	Money Impulse	PE ratio (3m% change)	PE 2013 Projected
February			14,15
March			14,15
April			14,51
May	45	2,3%	15,04
June	-22	-1,1%	13,99
July	-39	-2,0%	14,23
August	-51	-2,6%	14,66
September	-70	-3,5%	13,50
October	-90	-4,5%	13,59
November	-90	-4,5%	14,00
December	-90	-4,5%	12,90

Using our two most probable scenarios, we can derive a reasonable range of valuation for the S&P

	2012 EPS	2013 Projected Growth	2013 Projected EPS (US\$)	2012 PE Multiple	Andbank's projections for 2013 PE	Target Price	Current Price	Fundamental Change (%)
S&P (under the 1st scenario)	103,79	2,42	106,30	13,36	14,14	1.503	1.651	-9,0%
S&P (under the 2nd scenario)	103,79	2,42	106,30	13,36	12,90	1.371	1.651	-16,9%

24/05/2013

- ✓ This is the **range** of valuation we take as a reference for the S&P (1,371 – 1,503).
- ✓ Whenever the S&P breaches the limits during this year we recommend taking actions.

Conclusions

1. Money impulse is not going to accelerate in the future. Even could experience a negative pace in the case the Fed just decides to expand monetary base at a lower pace.
2. Therefore, the 2013 PE should stabilize at some point between 12.9 and 14.1 (well below the current level of 15 in PE ltm)
3. We keep unchanged our 2013 EPS growth estimates at 2.49% yoy.
4. Putting together all factors (EPS & PE), we obtain a fundamental valuation for the S&P that falls within a narrow range (1,371 - 1,503)
5. We “fundamentally” feel more comfortable with the 2nd scenario: A gradual slowdown in the expansion of monetary base starting in June-July, (although we recognize a low degree of predictive ability in any subject, and particularly in a political issue like this).
6. Therefore, we are more prone to think that 2013 PE should move closer to the lower band of our target range for PE (12.9 – 14.1) ...
7. ... so we still feel very comfortable with our PE proposal made at the beginning of the year (in the 13.3 area). That, together with our EPS projection (+2.49%), **gave us our target value of 1.420 for the S&P. A level that we have decided to keep stable.**
8. 1,420 is nothing more than our target value, and do not imply that we bet for a S&P price stalled at this level. Market participants think and make decisions differently each day, that is way prices move away from our “fair value”. Just take it as a reference to which we humbly think the market should quote at some point in the near to mid future.

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