REGIONAL STAR RATINGS

US (4.0 STARS – VERY ATTRACTIVE)

1. The US market (as represented by the S&P 500) trades at an estimated PE ratio of 12.7X and 10.8X for 2010 and 2011 respectively (as at 30 June 2010).
2. Earnings are expected to rise by 35.0% in 2010 and 17.6% in 2011 as the US economy recovers.
3. GDP expanded by an annualised 3% in 1Q 10, following a 5.6% q-o-q expansion in 4Q 09. 1Q 10 growth was 2.4% on a y-o-y basis.
4. Growth was driven by a 3.0% annualised quarterly increase in personal consumption expenditures, a third straight quarter of consumption recovery, suggesting that current estimates of sluggish consumer spending may be too conservative.
5. The consensus now expects growth of 3.2% in 2010, up from 3% at the end of Mar 10 and significantly higher than the 2.6% median forecast at the end of 2009 (Bloomberg consensus). We maintain our 3.7% growth forecast, cognizant that better-than-expected consumption figures could result in the final growth figure being even higher.
6. US Manufacturing and Trade Inventories rose for a fourth straight month in Apr 10, indicating that inventories have bottomed and have turned the corner. We expect that inventories will continue to rise; this is aligned with our forecasts that restocking activity should provide a boost of 1-1.4% to full year GDP growth.
7. Non-farm payrolls have rebounded in fits and starts, with the latest numbers for May 10 disappointing investors as only 20,000 (excluding the impact of census worker hiring) jobs were created. However, jobs have been created for five consecutive months, and the economy has certainly improved from the depths of the recent recession where over 700,000 jobs were lost each month.
8. Existing home sales have rebounded following a lull in early 2010 (which has been largely attributed to snow storms). Much of the surge in demand may be attributed to the impending expiring of homebuyer tax credits, which expire in Jun 10. Home sales may fall sharply in the months ahead, but it will be necessary for the housing market to reach a new equilibrium following the tax credit deadline for us to understand the underlying strength of US housing demand (unassisted by government incentives).
9. Problems in the Eurozone have led to economists adjusting their estimates of when a rate hike will occur. The consensus now expects the first rate hike only in 2011, which suggests that US commercial banks will be able to earn easy profits on the positive interest rate spread for a prolonged period of time. This will be crucial for consensus earnings estimates to materialise – the financial sector is expected to be the largest profit contributor in the S&P 500 by 2012.
10. The US dollar index surged to the highest level since Mar 09, largely due to the pronounced weakness in the EUR, which has suffered due to debt woes in several Euro-zone economies. As at 29 Jun 2010, the dollar index has surged 10.5% on a YTD basis, which could have a negative impact on US exports. We had earlier factored in a negative contribution from exports to US GDP growth, but the extent of impact due to currency strength will only be seen in the 2Q 10 GDP results.
11. Strong earnings growth is forecasted over the next three years, and aggregate earnings are expected to exceed pre-crisis highs by 2011. Given that expectations are substantially more optimistic, there is less scope for upward revisions in earnings, but valuations on a forward-looking basis remain attractive. We maintain a 4.0 star “very attractive” rating n the US market.