Al Buatti: Thank you, and good afternoon, everyone. Very glad you were able to join us. For today's program, we're fortunate to welcome back Jurrien Timmer. For the next 30 minutes or so, we'll hear Jurrien's perspective on the state of the current market, and then after that, we'll have a question and answer session.

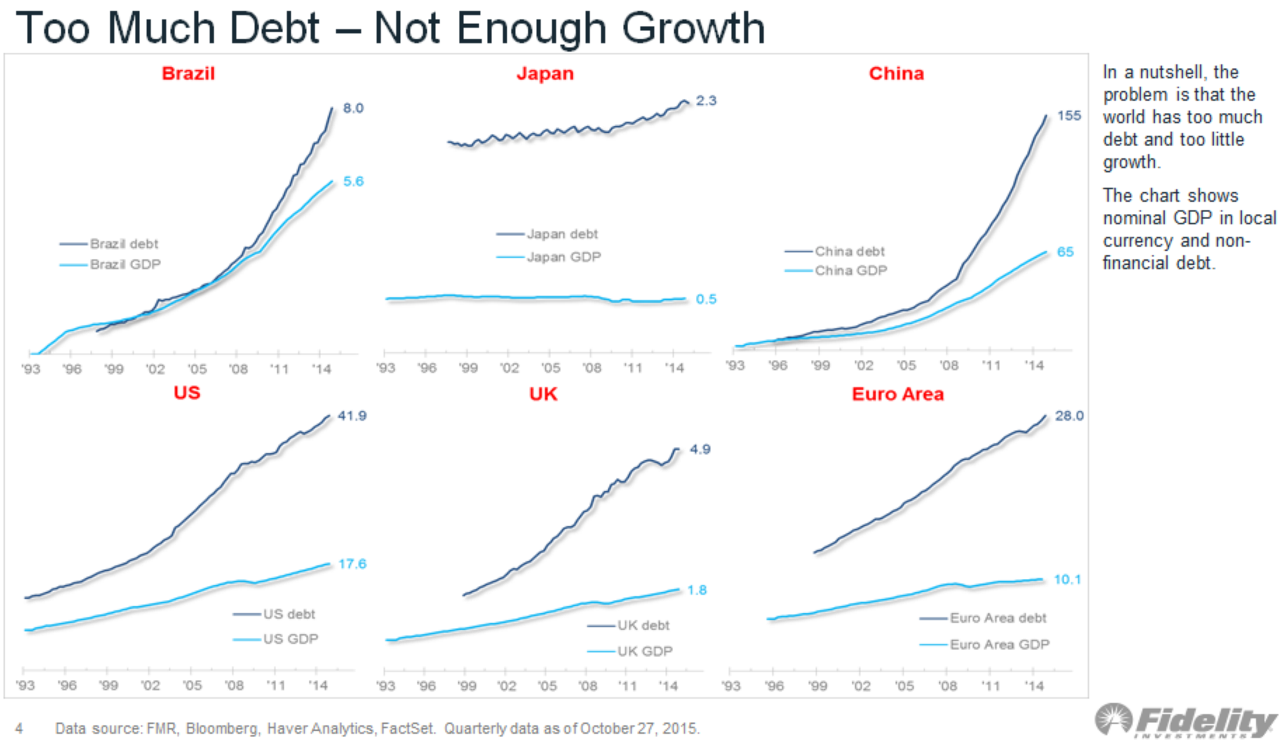
Jurrien is the Director of Global Macro Investing in the Global Asset Allocation Division here at Fidelity Investments. Jurrien has more than two decades experience in the investing world and is a 20-year Fidelity veteran. In Jurrien's role, he supports the asset allocation process of Fidelity's multi-asset class strategies group. In addition, Jurrien is responsible for analyzing market trends and synthesizing investment perspectives across asset management to generate market strategy insights for the media, as well as Fidelity's clients. Prior to assuming his current position in 2005, Jurrien was a director of market research from 1998 to 2005 and a technical research analyst from '95 to '98. Jurrien also co-managed the Fidelity Global Strategies Fund from 2007 to 2014. Jurrien's research is widely used by Fidelity's portfolio managers and analysts. And in addition to this internal role, he's also a spokesman on investment matters to Fidelity's clients and associates. We're really excited he's agreed to come back and work with us today. So without further adieu, Jurrien, I'll turn the floor over to you. Welcome.

Jurrien Timmer: All right. Well, thank you, Al, and welcome, everybody. I'm going to try to make sense of everything that's going on and give you a sense of how I'm looking at the world, starting all the way from sort of 100,000 feet to maybe 50,000, and then to 10,000. And hopefully we'll have enough time for Q&A at the end.

So let me start by at the most macro level possible. So we're living in this world where, you know, the Fed tries to raise rates, and they can't, and now China is having problems. And, yeah, we just can't seem to be getting out of our own way.

There seems to be these rolling crises, you know, starting with the financial crisis in '08, of course, and then, we hit the Eurozone crisis in 2011, and now, we seem to be having a

China problem. And the common denominator among all of these issues is that we're living in a world where there's too much debt and not enough growth. So you can see on this slide, it almost doesn't matter what country you take. Whether it's Brazil, Japan, or China, the U.S., or the euro area, there's been a huge buildup in debt. And, you know, the financial crisis was not the usual type of recession, which tends to be a business cycle, inventory type of recession. This one was a balance sheet recession, and it takes longer to recover from those. So that's why, here we are, seven years after the crisis, and our economy, is doing pretty well.



Too Much Debt – Not Enough Growth

In a nutshell, the problem is that the world has too much debt and too little growth.

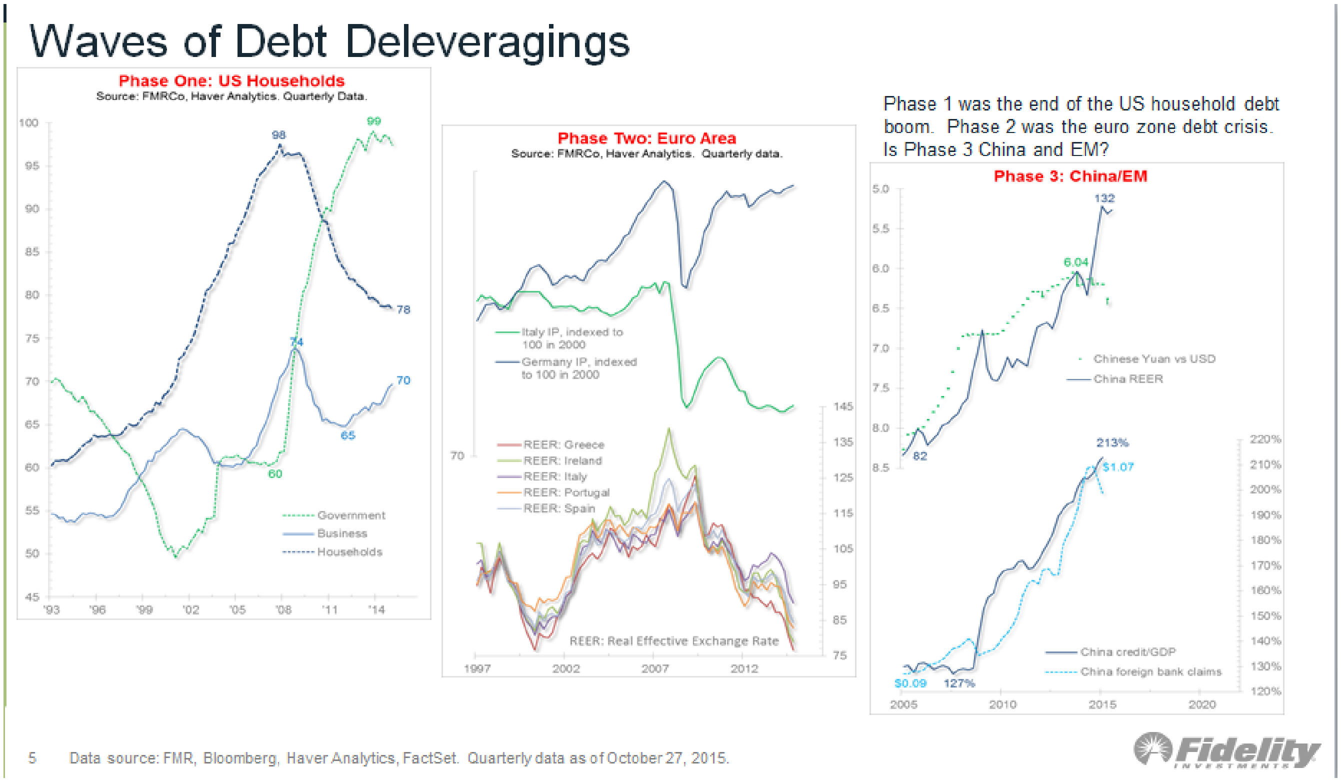
The chart shows nominal GDP in local currency and non-financial debt.

4 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Quarterly data as of October 27, 2015.

We're in sort of a mid-cycle expansion and the unemployment rate has certainly come way down from where it peaked in '08. But at the same time, we're still growing at only about 2% real GDP. We're growing so slowly that the Fed is not able to even lift rates off of zero, which, on the surface, seems kind of silly that we're still stuck at zero, even though the unemployment rate's gone from 10 to 5. But we're living in a very slow-growth world, and part of the reason for that is demographic, but a big part of it is that there's just too much debt. And I like to think of it as sort of a rolling crisis. If you look at this chart, it seems to be we're in sort of the third phase of, essentially, a debt deleveraging. So the first phase was U.S. households back in 2008. We all remember that time very clearly, and not so fondly, of course.

But as you all remember, during the late '90s, well into the 2000s, we had a major housing boom, and that allowed US households to essentially monetize their home equity, basically, to lever up their home equity into spending. And as a result, the household debt to GDP, which is on the left-hand side of the chart, went from about 60% to almost 100%. Then home prices started to fall and households had to de-lever, and the financial system, in general, had to deliver, and we had the financial crisis.

And now, indeed, households have de-levered quite a bit, so the debt-to-GDP ratio for US households is down to 78%, so certainly a lot of progress is being made there. And that was sort of phase one of what I think is global debt deleveraging super cycle, if you will.


Waves of Debt Deleveragings

Phase One: US Households

Source: FMRCo, Haver Analytics. Quarterly Data.

Phase Two: Euro Area

Source: FMRCo, Haver Analytics. Quarterly data.

Phase 1 was the end of the US household debt boom. Phase 2 was the euro zone debt crisis. Is Phase 3 China and EM?

Phase 3: China/EM

Data source: FMR, Bloomberg, Haver Analytics, FactSet. Quarterly data as of October 27, 2015.

Now, as you'll see on the chart, as the dark blue line goes down, the dotted green line has gone up, and that's government debt, so it's not like the US, as a whole, has reduced its debt. You know, our debt levels are higher now than they were five years ago, and that's because the government had to basically step in and substitute the spending that households could no longer do, and that this was -- this goes back to, you know, the Fed's response back in '08, with quantitative easing and zero rates, but also, the fiscal response to very aggressive deficit spending. And in my opinion, that was the right thing to do because it prevented something much worse from occurring, like we saw in the 1930s. You'll notice, also, on the chart, that the solid blue line is business or corporate debt, and that also peaked at 74%, went down to 65, but in recent years, has gone back up again, and is now back at 70. And that has to do with, of course, the availability of very cheap credit and the tendency for companies to basically use financial engineering to generate profits and shareholder returns. And essentially, they're borrowing money at very favorable terms and they're using that money to buy back shares. So that's the corporate side. But the main focus here is on the household side.

So that was wave one of a global debt deleveraging, and it's proceeding, and we were the first ones, in the US, to go through this, and it was very painful. But we have also kind of started to come out of it. I mean, if I look around, driving home, and I look at all the buildings that are going up in Boston and all the cranes that I see, the economy is doing pretty well in the U.S., for the most part. So that's wave one.

Then, we went to wave two, which is the middle chart, and that's Europe. And we all know the story with Greece, Italy, Portugal, and Spain, etc. That really came to a head back in 2011 and we had the sovereign debt crisis in Europe. And what happened there was, Europe, of course, has the European Monetary Union. They created the euro back in 1999 or 2000. And what that did was it kind of created a common denominator for all of Europe's countries. And of course Europe has very strong countries, like Germany or my homeland of Holland, and it has much weaker countries, like Greece and Portugal. And in the old days, you know, Germany would have much lower costs of credit than Greece would, as it should be, because Greece was sort of like the high-yield equivalent of Germany, which was sort of the AAA version of Europe's credits system.

But when they instituted the euro, essentially, it created a level playing field and the cost of borrowing for countries like Greece went all the way down to the same cost as Germany. So all of a sudden, Greece, which used to borrow at, let's say 10% or more, all of a sudden could borrow at Germany's credit rating and at Germany's interest rate. And what these countries did is they essentially binged on cheap debt.

They borrowed lots of money and they didn't really put it to very productive use. And their governments got bloated, and they got into a lot of debt. And the way I like to show that is in the bottom panel of that middle chart, which shows the real effective exchange rate. So it's essentially the exchange rate, which, of course, is the euro, divided by labor costs. And you can see that the exchange rates for all of these countries on the periphery of Europe went way up, and then in '08, the financial crisis hit. It resulted in a global deleveraging, debt deleveraging, and these real effective exchange rates had to go all the way back down, so that these countries could become more competitive again. And that was, of course, a very painful deleveraging process, and we all know the headlines from Greece, which re-emerged, yet again, this year, if only a few months ago.

But the good news is that, as you can see from that chart, the effective exchange rate has completely round-tripped back to where the euro was founded, and so a great deal of adjustment has taken place, and Europe is in much better condition for it. So I'm actually pretty bullish on Europe because they've taken the pain, and they've taken the hard measures, and they've become much more competitive, as a result. So that's Europe. So that was 2011, 2012. That was sort of the second wave, if you will.

And now we're on the right-hand side of the chart, and now we're looking at China. And what happened in China was that, you know, China's gone through this spectacular economic expansion over the past several decades, and the model for that expansion was, building infrastructure, creating a lot of investment. And a lot of that was done on credit. The government would instruct the banks to lend to state-owned enterprises and local government financing authorities. They would build schools, bridges, airports, railroads, office buildings, and apartments, etc. And then people would move into the cities. You had the whole urbanization thing and that would generate a lot of GDP because it’s a lot of economic activity. But the problem in China was that in 2008, when we had the financial crisis, the whole world, of course, came to a halt in terms of the economy. And then we had the policy response through quantitative easing, zero interest rates, fiscal spending, and then China also came to the rescue with a massive infrastructure program, about four trillion yuan, which is about six yuan to a dollar. And once you account for the multiplier effect of running that infrastructure plan through the banks, some estimates have it as more as 10 trillion yuan, which is about one and a half trillion U.S. dollars.

So it was a very big program, and it created some excessive speculation in terms of new loans going out. But the net result is that here we are, seven years later, and China’s economy is barely growing, even though its debt levels have continued to go up. And, the government just reported -- I think it was yesterday -- that GDP is at 6.9% and I personally don’t think that the economy’s growing at anything near 6.9% by our own estimates here, internally. We’re thinking it’s more like 2 or 3%. So we have less growth based on more debt. So each incremental unit of credit growth is generating less and less economic growth. And part of the problem in China is that its currency is tied to the US dollar. And what’s happened in recent years is that other countries have been reflating their economies, like Europe and Japan. And as they do that through quantitative easing, they’re bringing the value of their currency down. Just take Japan for an example. When they started this in 2013, the yen was at about 75 yen to the dollar, and now it’s about 125 yen to the dollar. So these countries have been very successful in devaluing their currencies through quantitative easing, which is when you’re trying to export your way out of trouble, you want to have a weaker currency.

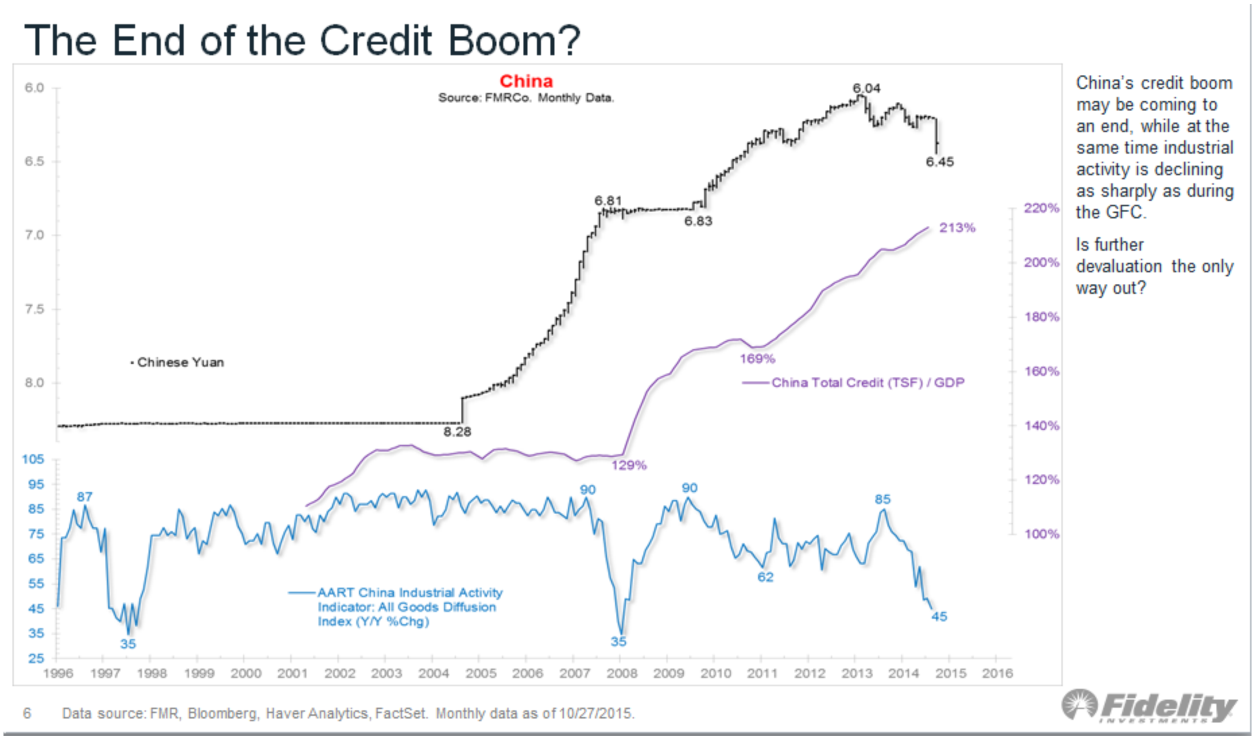
But as these countries do that, it means the dollar is going up, because the way currencies work is if, one currency goes down, the other one goes up. And as the dollar goes up, the Chinese yuan goes up, as well, because that currency is basically managed against the dollar. So if you look at the chart on the right, you see the solid line at the top is the Chinese real effective exchange rate. It’s gone way up over the past 10 years. And if you look at the bottom, debt-to-GDP has gone way up. So I'm not expecting, necessarily, a large debt deleveraging the way we've seen in the US and in Europe, because I think China does have a lot of leverage to pull. It is a command economy, as we all know, and so it's not a market economy, where things just kind of happen. So I don't know how it's going to play out, but to me, this is sort of the new frontier or the current frontier of this debt deleveraging super cycle.

And it's not just China. It's emerging markets, in general, and that's why that part of the world has been so weak this year. And part of the problem is, as the dollar goes up, a lot of corporations in emerging markets, including China, they've borrowed money in dollars. And a lot of these corporations are in the business of selling commodities to China. So when China slows, because the dollar is going up, and because China has too much debt and too little growth to service that debt, these countries that sell to

China, like Brazil, not only are they getting fewer revenues to pay off their loans, but they're paying off those loans in dollars, which are going up. So they're kind of getting squeezed from both sides, and this is why we're seeing stresses in emerging markets this year. So to me, this is sort of the 100,000-feet view of why we've been in this predicament and why the market sold off this year. Essentially, it was a collision course between kind of a tightening up—a deflationary shock, coming from emerging markets and China at the same time that the U.S. Fed, our central bank, was trying to raise rates, and I'll get to that in just a moment.

But just to give you a little bit more of a background on China, this chart below show—if you look at the bottom panel—a measure of industrial activity in China. This is our own internal measure, and you can see how it has been falling in recent months. And it's falling to levels, not too far from where we were in 2008 or in 1997-98, which was the Asian flu. And if you look at the middle panel, that's the total debt-to-GDP. And you can see how hard that has gotten. So China does have some imbalances to deal with here. And if you look at this next chart (below) if you look at the bottom panel, those are capital flows in China. So one of the issues in China has been that its currency is too high. It's overvalued.

And by our estimates, it's overvalued by about 15 to 20%. And China wants to try to export more because its trade balance has shrunk, because as China's economy slows, it's been importing fewer goods. So the exports are still good, but the imports have less, so they're trying to export more to improve their trade balance, and that means they need to bring the currency down, which they did in August, when they devalued the yuan byonly about 2 or 3%, which doesn't seem like a big deal.



The End of the Credit Boom?

China's credit boom may be coming to an end, while at the same time industrial activity is declining as sharply as during the GFC.

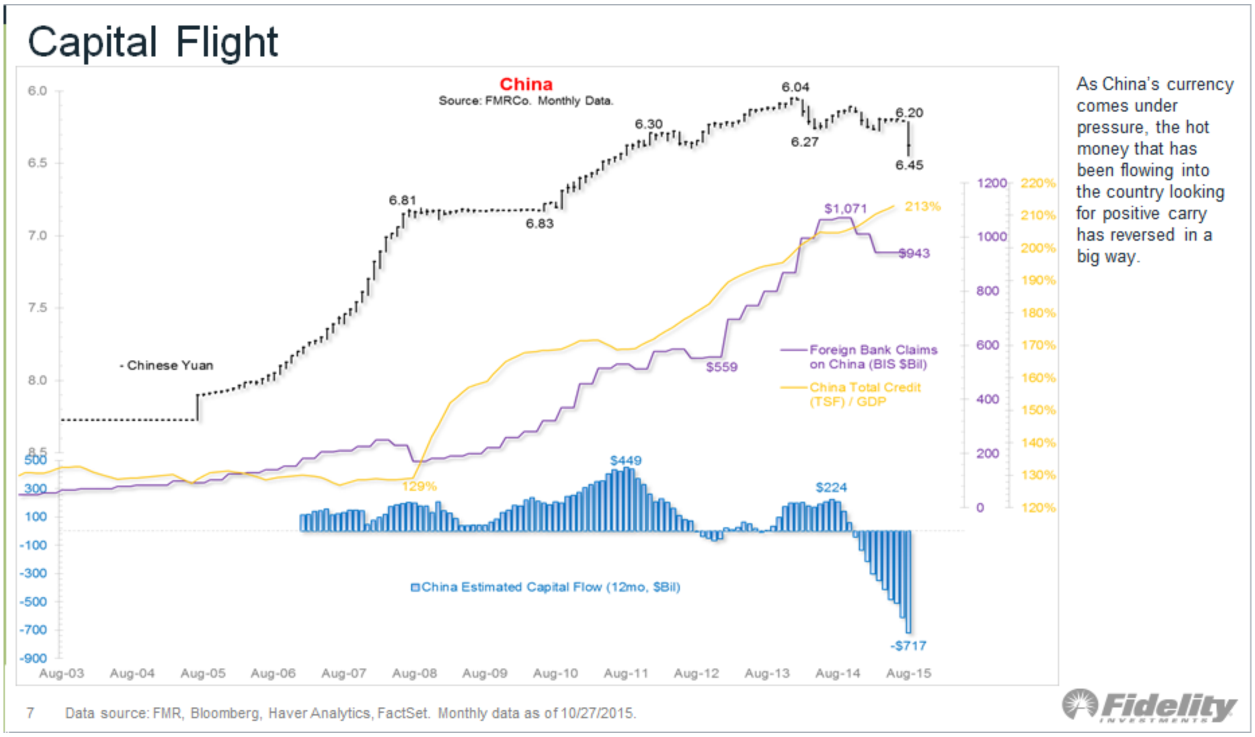
Is further devaluation the only way out?

6 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Monthly data as of 10/27/2015.

But there's a lot of hot money in China, money that's come in through the Hong Kong banks, looking for a better return in the Chinese financial system. And so capital flows have been very strong going into China, especially when the currency was going up, and you can see that in this chart above, until recently, the Chinese yuan had been going up for a number of years, and if you look at the purple line in the middle, those are the capital flows going into China. So that money has been following sort of the improving currency and the better interest rates that they could get in China. But now that pattern is reversing, and so when the Chinese devalued their currency, it put a lot of pressure on it, because this hot money essentially started to leave, and then the Chinese Central Bank has to defend its currency from falling too rapidly. And that means that they had to basically draw down on their foreign exchange reserves. And this is an important concept because the notion of foreign exchange reserves is one form of liquidity.

So if you think about the global economy and the global financial system, the market thrives on, basically, two things, and I'm talking about the stock market now. Obviously, it does better when earnings are growing. I mean, we all know that, so price follows earnings. But it also tends to thrive more when the liquidity environment is ample. So if central banks are cutting rates or printing money through quantitative easing, or if a lot of the U.S. consumer, like he did a decade ago, is buying a lot of stuff that's being manufactured overseas, dollars go overseas. It creates trade flows. Those trade flows end up on the balance sheet of emerging market central banks. And it's all kind of liquidity that sort of makes the world go 'round. So there are different forms of what we can call easing and tightening, and the central banks are part of that, but global trade flows, and therefore, global foreign exchange reserves, which follow those trade flows, are part of the same story.

So if you look at this chart below, in the bottom, you see two lines. The blue line is the growth, the annual flow of foreign exchange reserves, global foreign exchange reserves. The yellow line is the annual flow of, essentially, central bank balance sheets, quantitative easing. And so these, to me, are the two forms of easing and tightening. So the easing comes from the central banks; the tightening comes from when there's a deflationary shock in the emerging markets and it makes central banks having to sell their reserves down to defend their currencies. And what you can see is that we're now in the third sort of deflationary shock.



Capital Flight

As China's currency comes under pressure, the hot money that has been flowing into the country looking for positive carry has reversed in a big way.

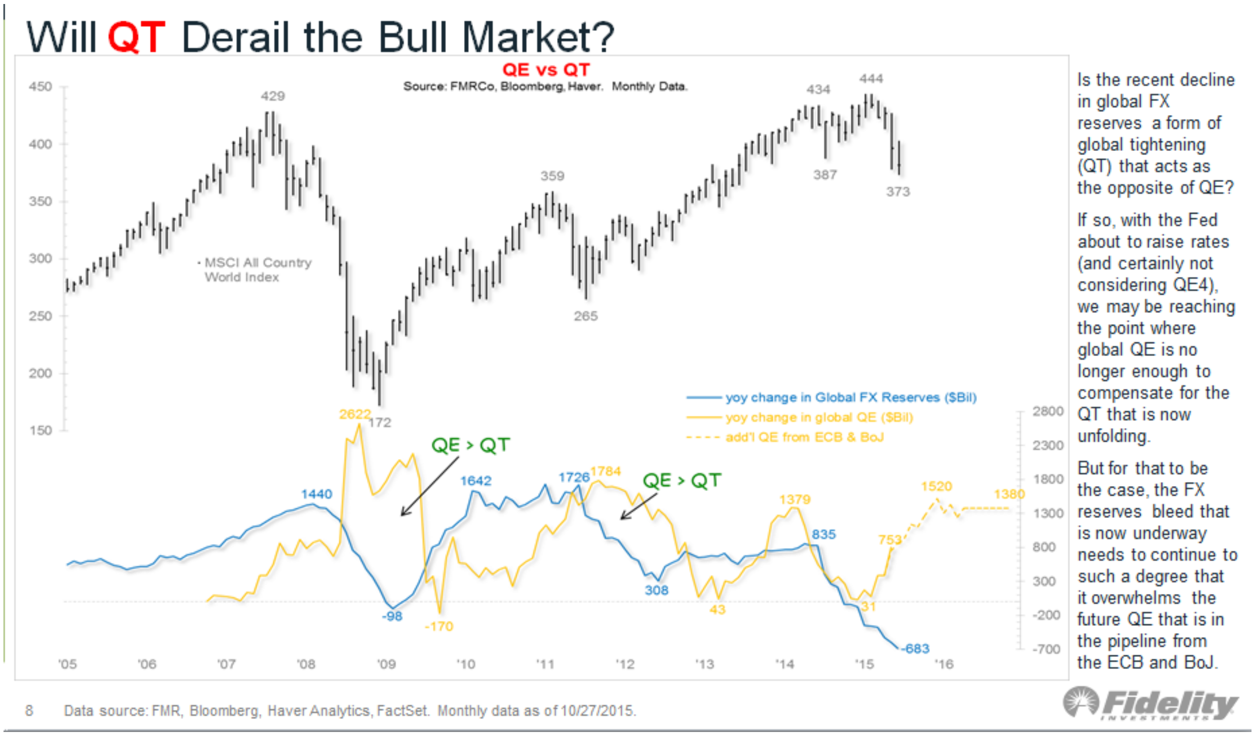
7 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Monthly data as of 10/27/2015.

And again, I come back to a few charts ago, where I mentioned the three ways of this debt deleveraging super cycle. So the first wave was in ’08. You can see the blue line falling in ’07 and ’08. That was a big drawdown in foreign exchange reserves. It was about $1.4 trillion or so. And then the response by the central banks, as we all remember, was massive stimulus, zero rates, quantitative easing. And it got us out of the crisis, and the market rebounded very, very strongly. Then, in 2011, when China was tightening, because it had basically over-stimulated, the same thing happened. So the FX reserves would draw down as global trade started to slow, and again, the central banks had to come in. The Fed was doing QE2 or QE3. I can’t even remember which one. The ECD was also involved. And again, the monetary response was ample enough to offset the deflationary shock of this quantitative tightening.

But now look at the right-hand side of the chart below and you can see an even bigger drawdown in foreign exchange reserves. And this has been the big story for this year. And, you know, we do have central banks still printing money. The European Central Bank, of course, is doing a very aggressive QE program of 60 billion euros per month. The Bank of Japan is also doing a big program. But the Fed is now on the sidelines. The Fed ended

QE3 about a year ago, so there's been no balance sheet expansion by the Fed, and the Fed, actually, is trying to raise rates on top of that. So once again, we have a little bit of an imbalance here between the forces of deflation via quantitative tightening and the forces of reflation via quantitative easing. And this is what's been creating problems in the markets all year.

And just to give you a sense of where things are, the Fed, of course, was trying to raise rates, at first, in June, then in September, and now, there are still some people on the FOMC who would like to start raising rates in December. Personally, I don't think it's going to happen because the reasons that were stated for liftoff in September are still very much in place, and December is only two months away, and certainly, October—that meeting's coming up in a week or so. I certainly don't expect them to raise rates then. But if you look at this chart here, the light, solid line is the Fed fund's target rate. So that is the official policy rate by the Fed. It's really the only rate that the Fed actually sets, and it's the rate -- the interest rate at which banks can lend from each other. And at this point, you know, it's not really an overly relevant rate, because banks are so overly reserved because of all the quantitative easing that took place. The last thing banks need to do is borrow money from each other, because they're sitting on trillions of dollars of excess reserves. But this is the policy rate. It's what everybody looks at.



Will QT Derail the Bull Market?

Is the recent decline in global FX reserves a form of global tightening (QT) that acts as the opposite of QE?

If so, with the Fed about to raise rates (and certainly not considering QE4), we may be reaching the point where global QE is no longer enough to compensate for the QT that is now unfolding.

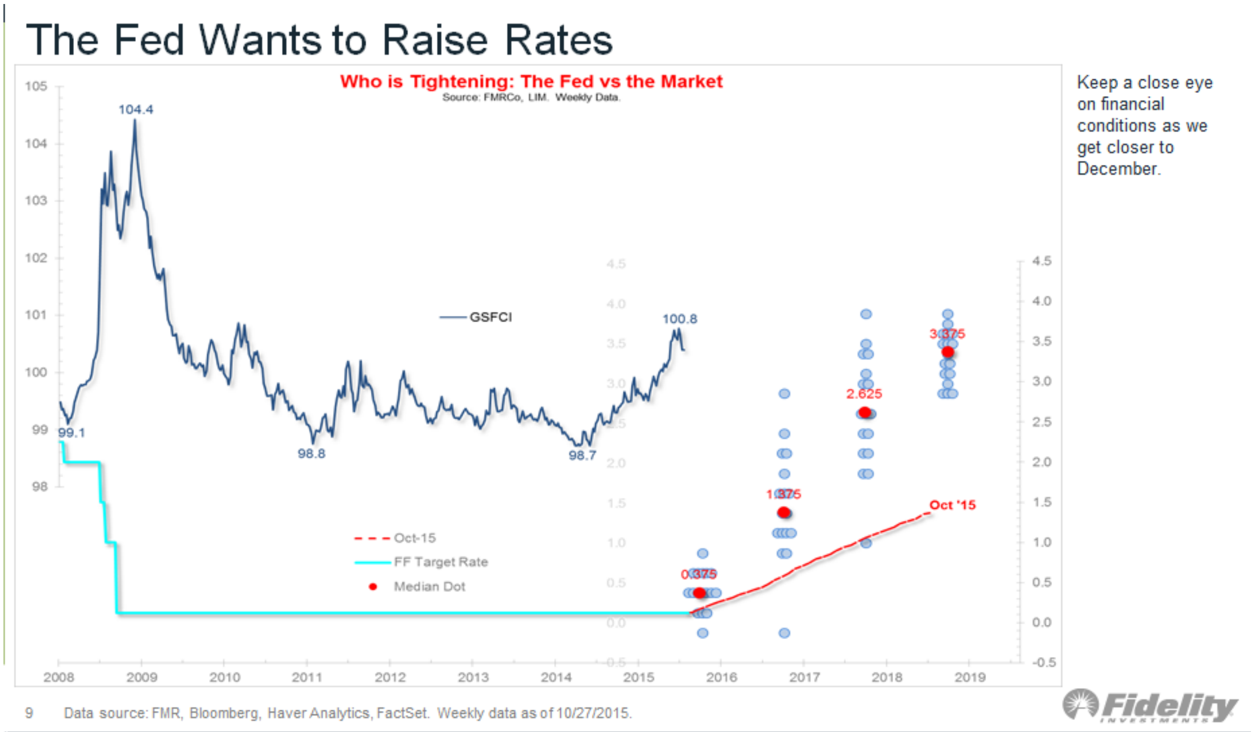
But for that to be the case, the FX reserves bleed that is now underway needs to continue to such a degree that it overwhelms the future QE that is in the pipeline from the ECB and BoJ.

Data source: FMR, Bloomberg, Haver Analytics, FactSet. Monthly data as of 10/27/2015.

If you look at the dotted red line, that is what the market is expecting the Fed to do. So this is the Fed fund's futures curve. And as you can see, when you compare that red line to the dots -- and those are the famous fed dots, which is essentially what all the Fed FOMC members believe the Fed is going to do over the coming few years -- you can see that the red line is far below almost all of the dots. And this has been a story that's been in place now for several years. And it shows that the Fed is -- seems to be far more optimistic about the economy going forward than the market is. So the Fed is saying, yeah, we're going to lift rates to 2 or 3% over the next couple years. And the bond market is saying, yeah, I don't think so. Maybe to one and a half percent, but no more.

So that's where we are with the Fed. And if you look at the dark blue line on the top of the chart, that is an index of liquidity conditions. So this is the Goldman Sachs financial conditions index. And it's a measure of whether the market is easing or tightening. So it's important to distinguish that, you know, the Fed can say or do whatever it wants, but the markets are really the key mechanism here. So if the markets are tightening because the dollar is rising or credit spreads are widening -- in other words, it's becoming more expensive for corporations to borrow money, or because inflation expectations are falling, that's essentially the market tightening for the Fed. And that's exactly what's been going on for the last six months or so. And you can see that from that line.

So typically, when that line is going up to the degree that it has been, usually, the Fed is actually easing, not tightening. And this time, the Fed has been trying to tighten into that environment, while at the same time, as I showed in the previous chart, foreign exchange reserves in emerging markets and China have been getting drained, which is also a form of tightening. So in retrospect, it's -- you know, I wonder why the Fed was even thinking of tightening in September because the world financial markets were essentially already seizing up in a way. And the Fed, to its credit, in September, say, you know what? We can't tighten into this environment because, you know, the markets are already tightening for us. So I think the Fed was very wise to listen to the markets in September when they opted not to raise rates. And I suspect that they will do the same in December. So that's sort of the environment. So we were on this collision course of quantitative tightening -- on the one hand, a declining amount of quantitative easing, now that the Fed is on the sidelines on the QE front, and on top of that, the Fed looking to raise rates on top of that. And that collision course has been averted now because the Fed, essentially, has blinked, and I think that was the right choice.

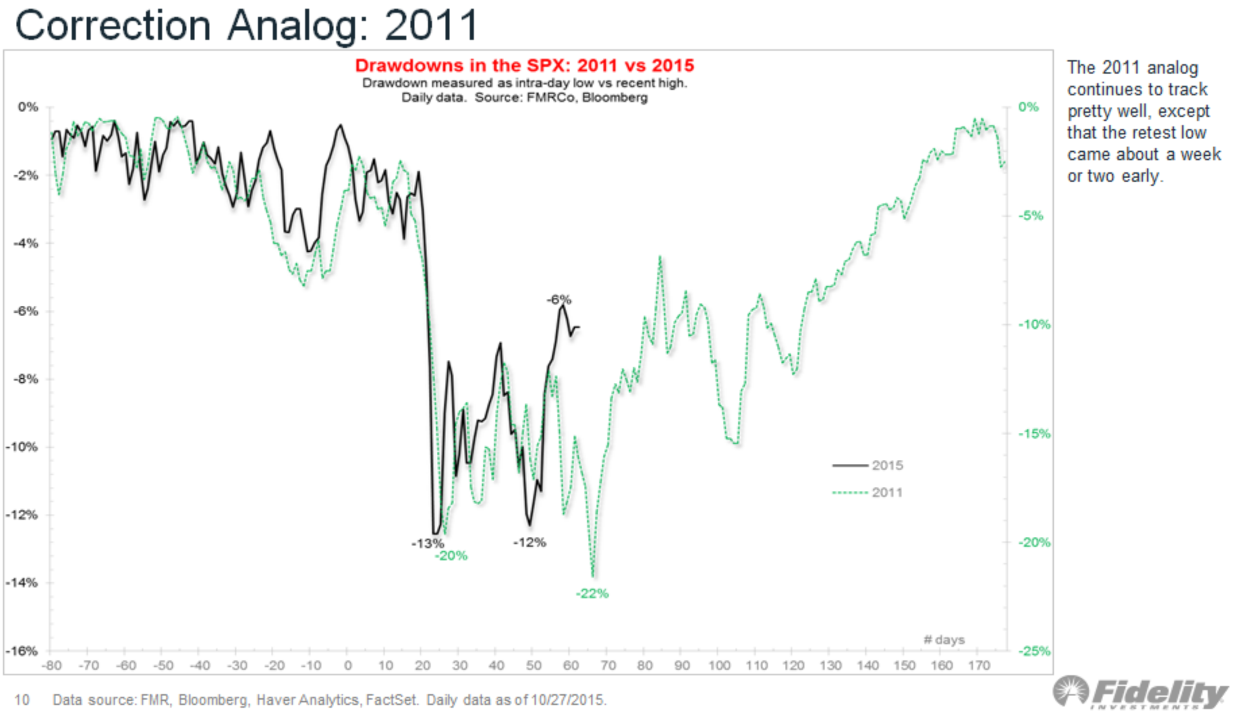


The Fed Wants to Raise Rates

Keep a close eye on financial conditions as we get closer to December.

9 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

So that is sort of how we got to where we are. So it all culminated in August with what we politely call a volatility event, otherwise known as a correction. And this chart shows, you know, a drawdown, essentially, the amount of decline -- the percentage that the S&P 500 declined from its high during August and what it’s done since. And the dotted green line is kind of an analogue that I like to use, knowing, of course, that analogues are -- you know, com-- historical comparisons are really not a very scientifically robust way of looking at things. But, you know, the market does tend to repeat itself in certain ways. So the green line is the 2011 decline that we had in that summer, when the US debt got downgraded and we had the Eurozone debt crisis. And at that point, the market fell about 22% from its -- at its lowest point. And, you know, there are some similarities between that period and this period.

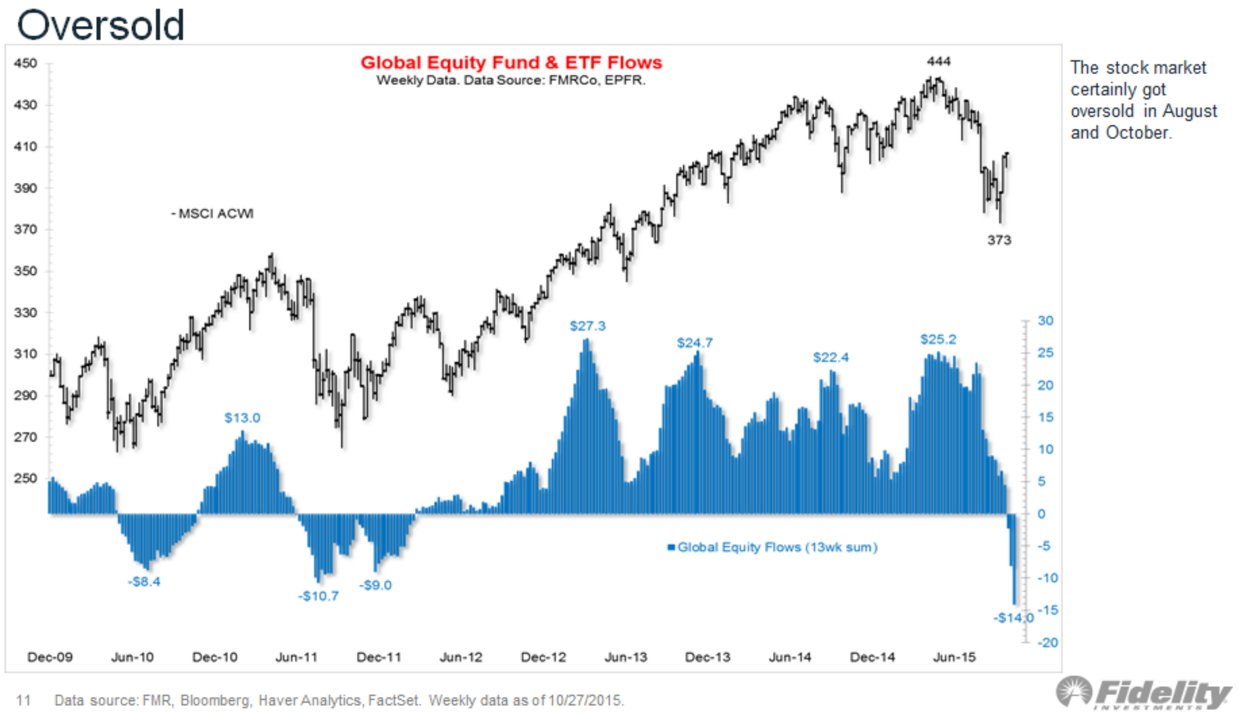


Correction Analog: 2011

The 2011 analog continues to track pretty well, except that the retest low came about a week or two early.

10 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Daily data as of 10/27/2015.

So in August, the market fell. We all remember that. It was shortly after the Chinese devalued. Nobody saw that coming. Then we had a rally. It was not a very good rally. And then we had a retest only a few weeks ago. And since that retest, the market has been much, much stronger, and actually looks to be on a pretty good footing, at least from a tactical point of view. This chart here just gives you another way of looking at this. The bottom panel shows investor flows into all global equity funds and ETFs. And you can see that for the first time in a number of years, these funds were actually being redeemed. And as usually happens, they got redeemed at the bottom. And that's why I always tell people when I'm on CNBC or in front of an audience is, you know, what you should do when these things happen is stick to your plan.



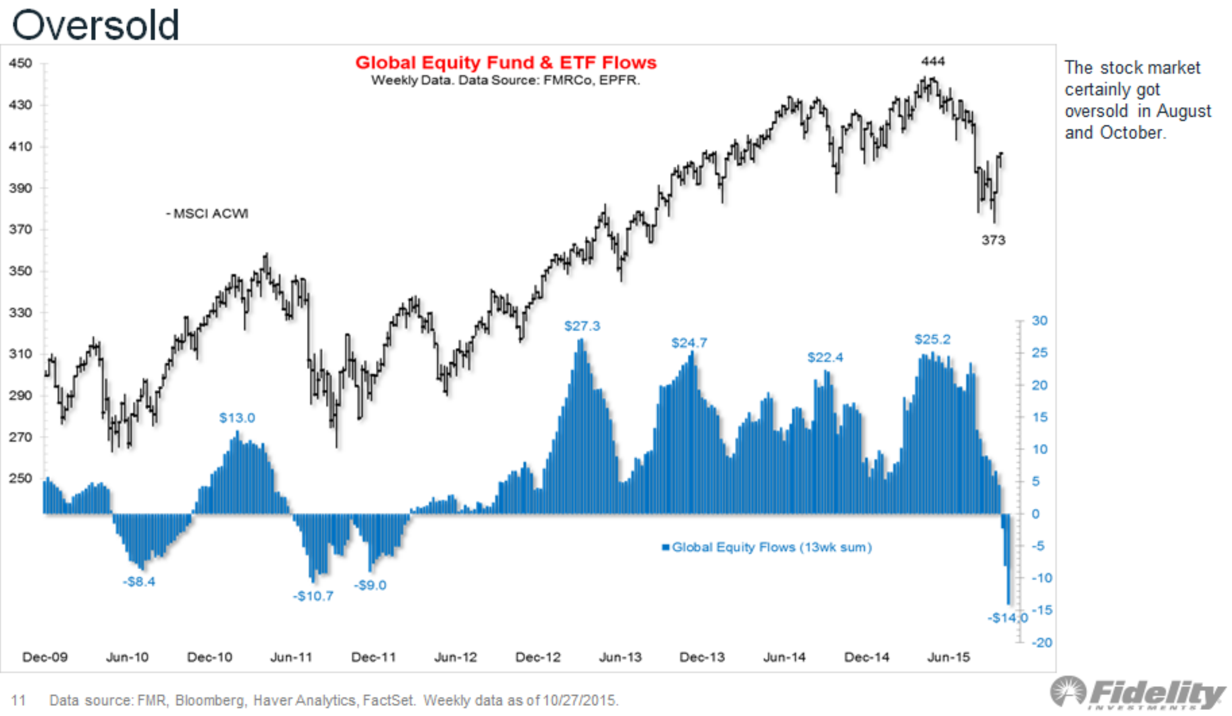
Oversold

The stock market certainly got oversold in August and October.

11 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

Make sure that you have a good plan and that you stick with it so that you're not that person who sold low. And I think a lot of people are going to look back at this particular period and say, you know, why did I do that?

So the market got very oversold. You can see this, also, in this chart. The bottom line shows the market's internal breadth, so the number of stocks that are above or below their moving average. And it got very, very oversold at the bottom. Then we had a successful retest, and since then, the momentum has been much stronger. And now we're sitting right at a resistance line, which used to be the support line, and the market is struggling a little bit here because that's the way markets behave. You know, when you get to support a resistance, usually the traders will use that as a place to get in or out, and so we're kind of struggling a little bit here, and we'll have to see if we get above that or not.

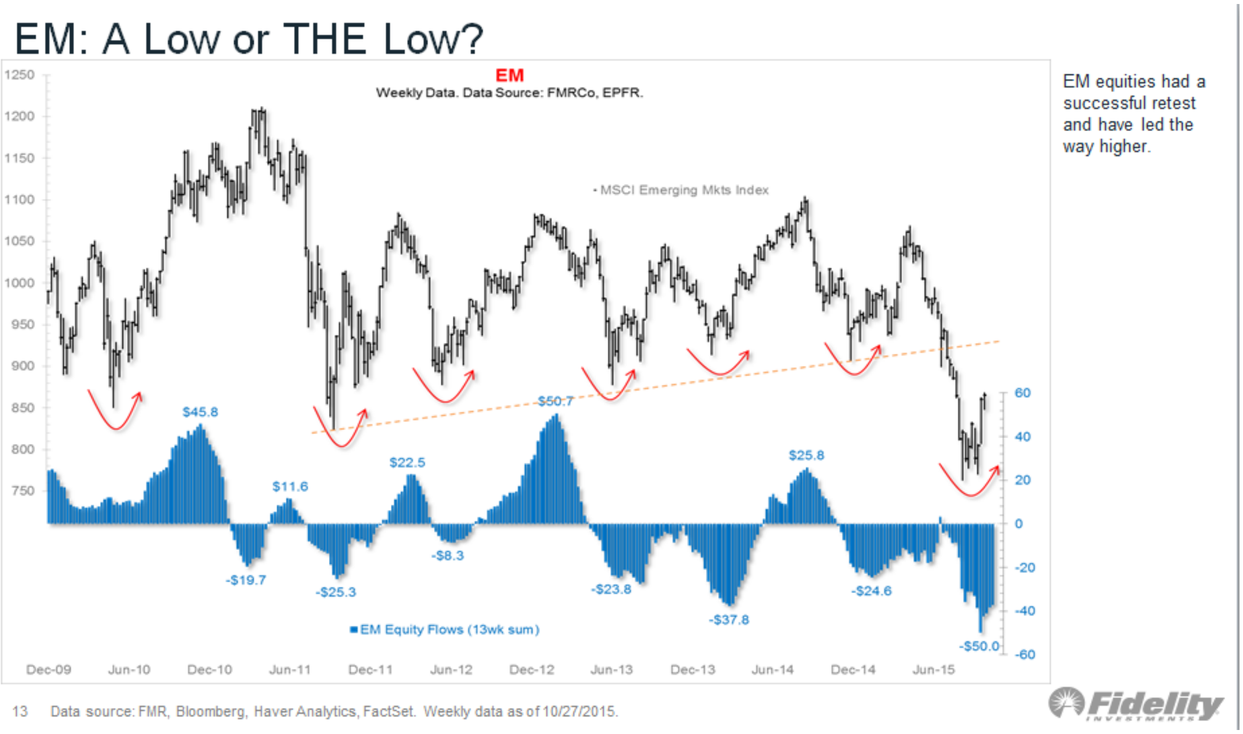


Oversold

The stock market certainly got oversold in August and October.

11 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

This chart just shows emerging markets. They were -- as I mentioned before, they were certainly at the forefront, taking the brunt of the selling, and certainly a lot of weakness there. And another part of the market that got very, very weak was credit, especially high-yield corporate bonds. And this is a very important economic indicator because, obviously, this is a real-time measure of what the rates are that companies can borrow when they're below investment grade. And that spread went way up to about 6 or 700 basis points. A lot of that was because of the energy sector because of the decline in oil prices, of course. But the good news is, is that, since then, spreads have come down a fair amount over the last couple weeks.

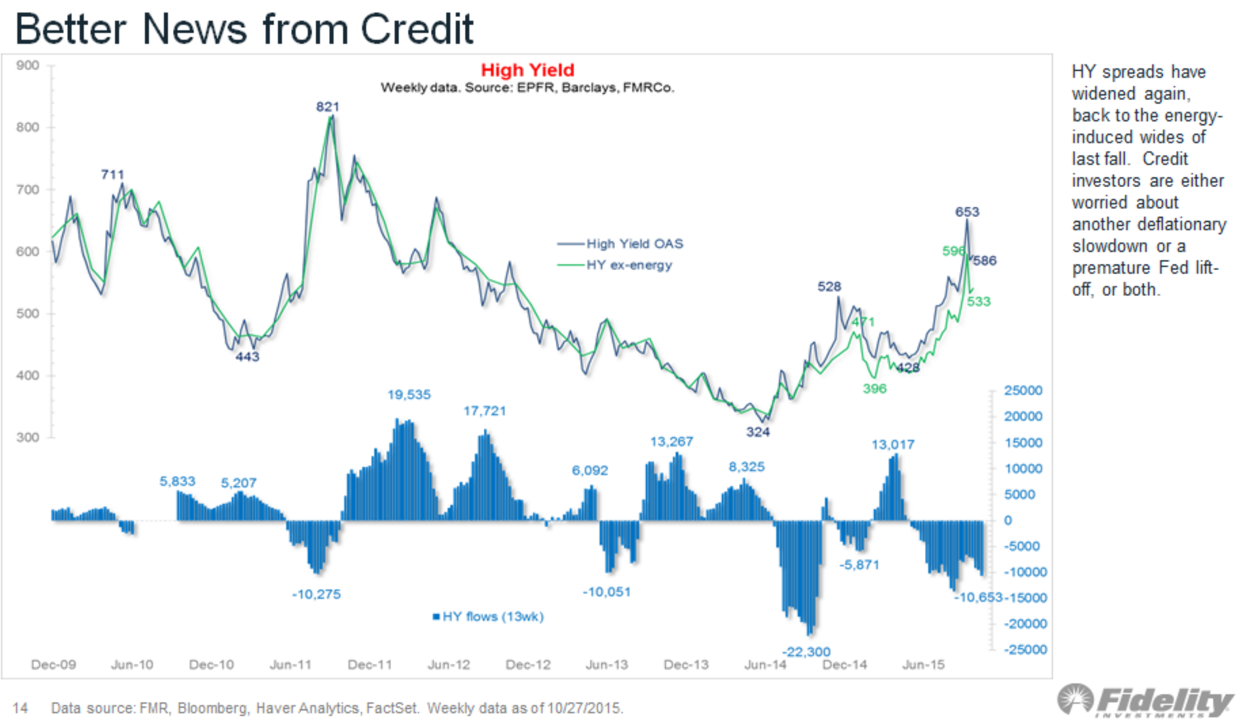


EM: A Low or THE Low?

EM equities had a successful retest and have led the way higher.

Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

So the strength that we're seeing on the equity side is being supported by better action the credit side. So credit is often a very important leading indicator for the stock market. It certainly was in '08. It was credit that went first and the stock market followed. So I look very, very carefully at the credit markets, especially credit excluding energy, because energy, of course, is its own story because of the fall in oil prices and what that did to the shale industry, and all the borrowing that took place in the shale industry for capital spending programs, and that happens the high-yield corporate bond markets. So credit, very, very important.

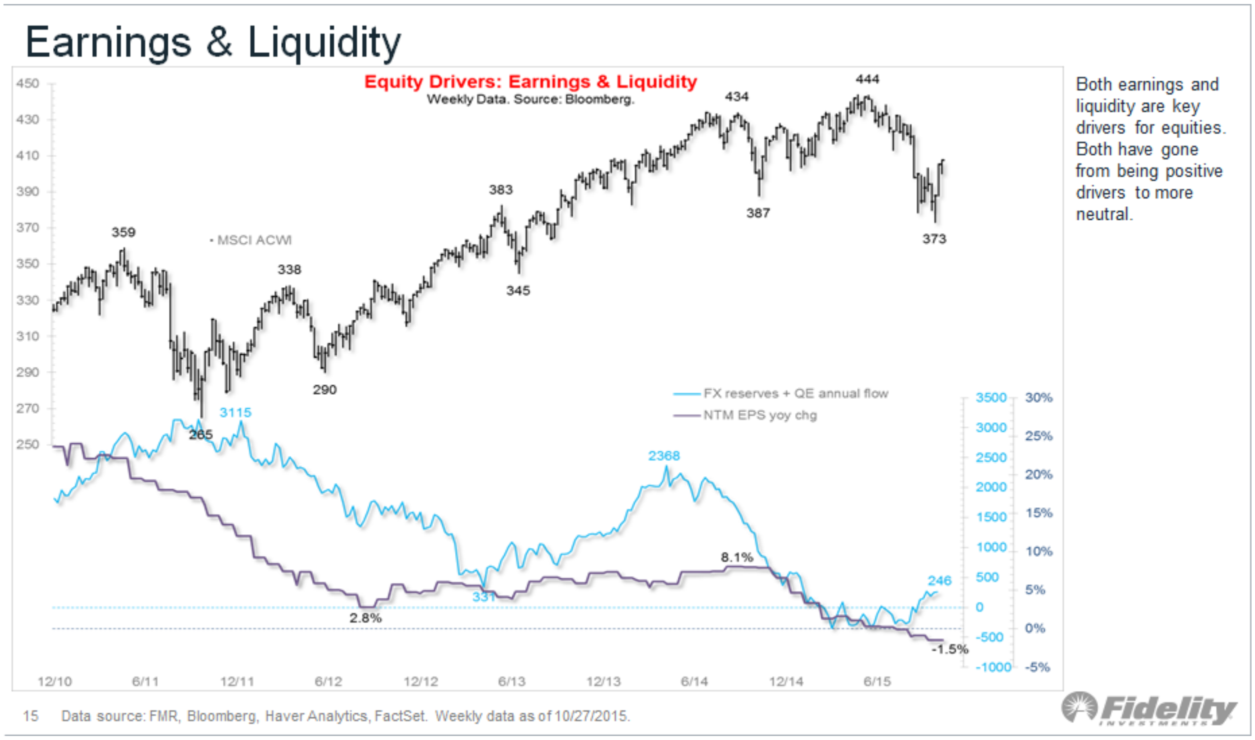


Better News from Credit

HY spreads have widened again, back to the energy-induced wides of last fall. Credit investors are either worried about another deflationary slowdown or a premature Fed lift-off, or both.

14 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

So how do I make sense of all of this, and how do we go forward? As I mentioned, for me, the two main drivers for the stock market are earnings and liquidity. And so earnings is pretty straightforward. You know, earnings go up; stock market usually follows either as quickly as earnings, if P/Es remain the same, or they go up more quickly if P/Es are expanding, or they go up less quickly, or even go down if P/Es are contracting. But usually, when earnings are going up, stock prices go up, as well. And then, if you have a favorable liquidity environment, it makes valuations go up, and that creates even more outside. So if I can pull everything together from what I just talked about -- again, this chart shows the S&P 500 on the top, and the bottom panel is -- so I showed you before the quantitative tightening versus the quantitative easing as the two forces of deflation and reflation. And when I just add the two up, I get the light blue line. And as you can see, that light blue line has been going down all year, and now, finally, it's starting to pick up because China seems to have stopped the bleeding in terms of its drainage of foreign exchange reserves. So China seems to be managing this currency situation that they have very well, and things are starting to get very quiet, which is a good thing. And at the same time, earnings growth has been slowing almost entirely because of the decline in oil prices, because the energy sector had produced such an outsized contribution to earnings that as oil prices came down, it also detracted a disproportionate amount of earnings. So earnings growth is actually now slightly negative. And so we're in a situation where we have neither help from the earnings front, nor from the liquidity front. And this is why the market is essentially flat to down on a year-to-day basis.

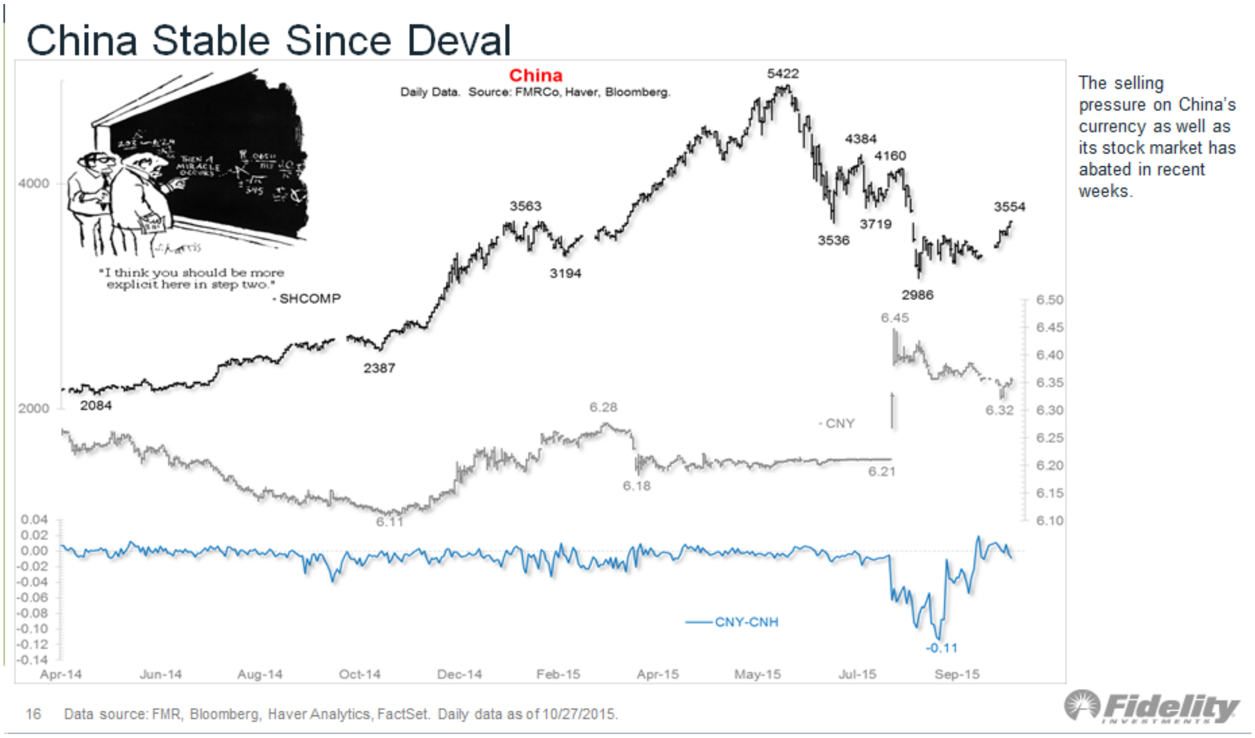


Earnings & Liquidity

Both earnings and liquidity are key drivers for equities. Both have gone from being positive drivers to more neutral.

15 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

Now the good news is that we do know that there is more quantitative easing coming from Europe and Japan. We also know that the Fed is listening to the market by not raising rates. So the overall monetary environment, I think is, you know, at least not as bad as it was three months ago, especially given that China seems to be managing this currency adjustment pretty well now. And at the same time, even though earnings growth is now negative, like I said, that's almost entirely due to energy. And if you strip out energy, earnings growth for 2015, using the consensus earnings estimate, is expected to grow at about 7%. So X energy -- and energy's only 8% of the market -- earnings growth is still OK. So looking forward, if the Central Bank monetary liquidity environment stabilizes, which it seems to be doing, and oil prices stabilize, which they've also done -- we're at $45. We went as low as 38, but we're kind of in the 45 to 50 range, and if we stay there, then eventually, the earnings bleed from energy will dissipate and will start to trend more towards a mid-single-digit earnings growth environment. And with valuations reasonable -- and I'll show you that in just a second -- that creates sort of a mid to -- let's say a mid single digit environment for the stock market, which is not great, but it's not terrible, either.

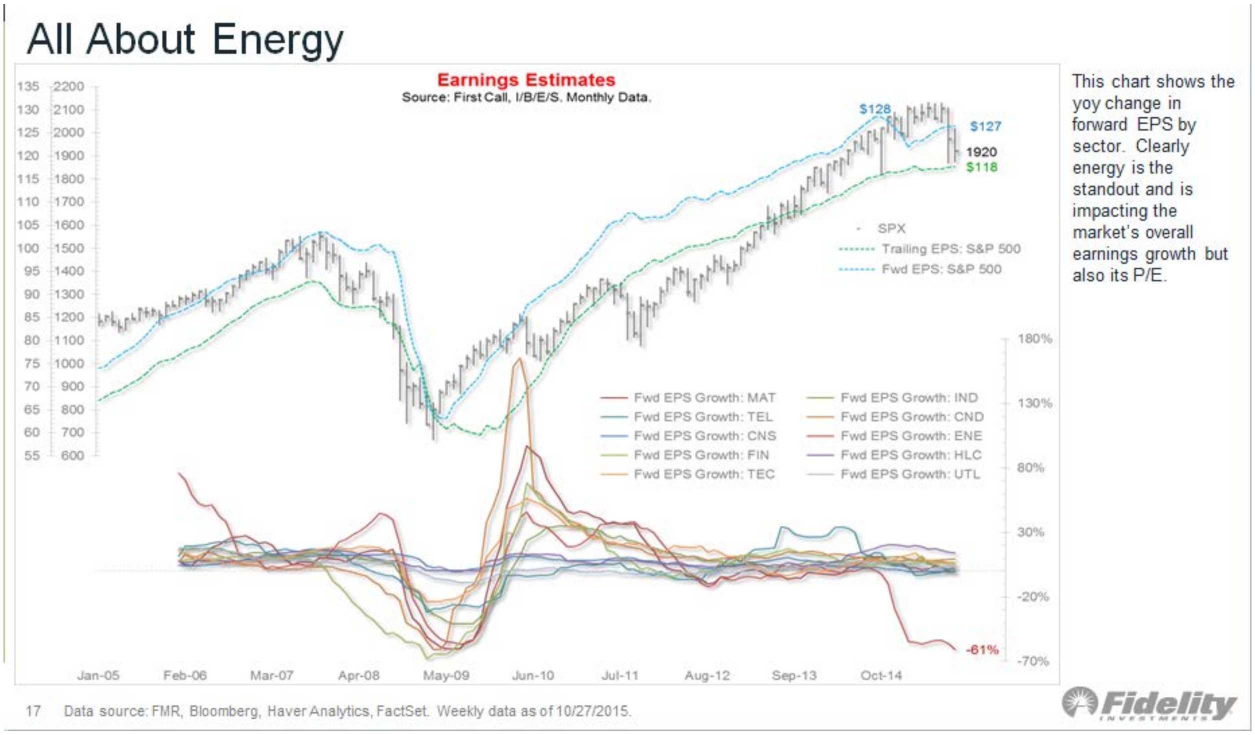


China Stable Since Deval

The selling pressure on China's currency as well as its stock market has abated in recent weeks.

16 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Daily data as of 10/27/2015.

So let me just -- so this chart here just shows the contribution of energy earnings. So if you look at the bottom panel, that's the year-over-year growth rate in earnings from each of the 10 sectors in the S&P 500. And you can see that 9 out of the 10 are all kind of in the sort of low to mid single digit range. And then you have energy as, obviously, the one that sticks out with a minus-61%. So it is all coming from one sector, as opposed to 2008. If you look to the left of the chart, it was most sectors really going down, and this time around, it is basically one sector. So it is a different story, in that sense, than we had in '08. And it's really, you know, kind of a special situation with the price of oil, again, which is tied to emerging markets and China. So the whole thing relates to each other. But a lot of this comes down to how China manages this transition from having too much debt and an overvalued currency and how they kind of, you know, transition from that to something more stable, where they have an economy that's more focused on domestic consumption and less on infrastructure spending. And so if they manage that well, and we don't get another aggressive draw down in the currency reserves, then I think we're looking at a fairly benign outcome. But, you know, there are a lot of ifs in that statement.

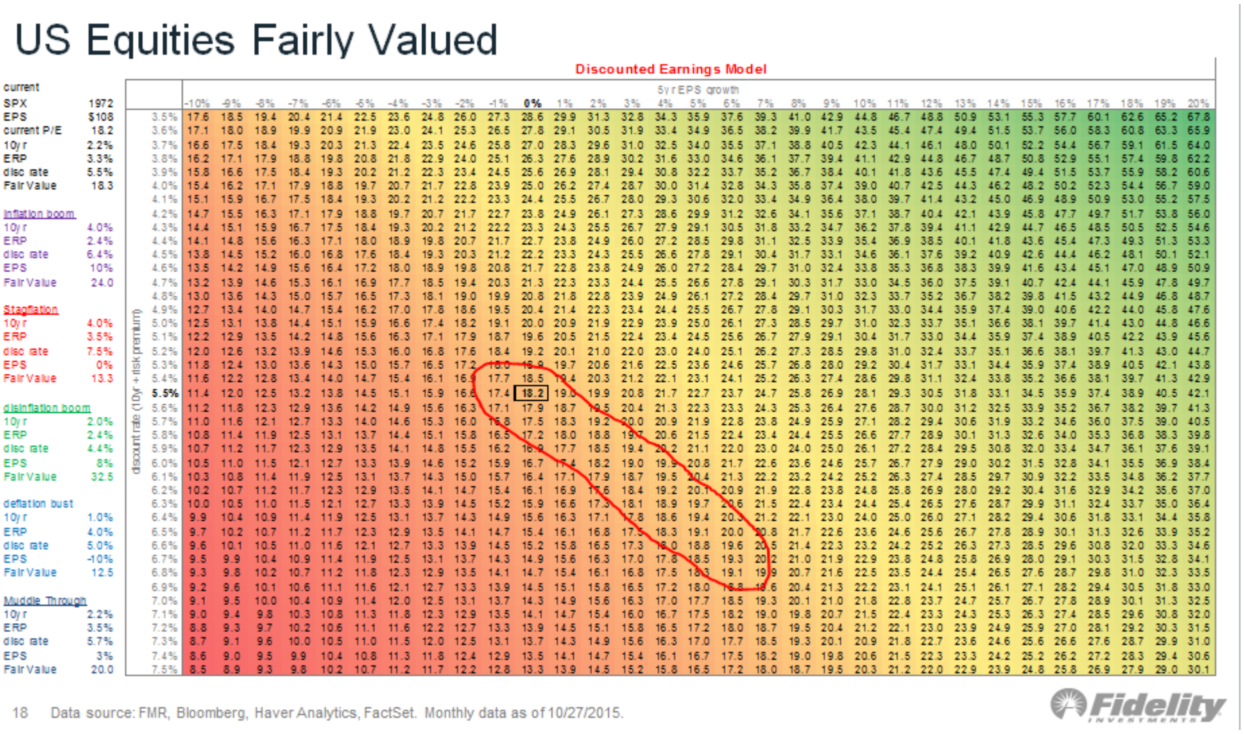


All About Energy

This chart shows the yoy change in forward EPS by sector. Clearly energy is the standout and is impacting the market's overall earnings growth but also its P/E.

17 Data source: FMR, Bloomberg, Haver Analytics, FactSet. Weekly data as of 10/27/2015.

And why don't I finish here, because I want to make sure we have enough time for Q&A. But you may not be able to see this because it's a very busy chart, but essentially, this is a heat map of valuations. And I get this question a lot. A lot of people think that the market is a bubble. If I had a nickel for every time somebody on CNBC calls the market a bubble, I'd have a lot of nickels, and I think it's a -- very much an overused term. But there's a school of thought that, you know, interest rates are too low, and that has sort of inflated other markets, like the corporate bond market and especially the stock market. And I don't really agree with that. Right now the P/E for the stock market on a trailing earnings basis is 18, and on a forward earnings basis is 15. And that's pretty much, I think, where the market should be valued, given their interest rates are and where earnings growth is. And you'll see a sort of a red blob there. And to me, that's where I think the market belongs. So it’s right among sort of -- you know, you see the diagonal yellow color -- we’re kind of on that line there, so of about 18 times trailing earnings.



US Equities Fairly Valued

current	
SPX	1972
EPS	$108
current P/E	18.2
10yr	2.2%
ERP	3.3%
disc rate	5.5%
Fair Value	18.3
Inflation boom	
10yr	4.0%
ERP	2.4%
disc rate	6.4%
EPS	10%
Fair Value	24.0
Stagflation	
10yr	4.0%
ERP	3.5%
disc rate	7.5%
EPS	0%
Fair Value	13.3
disinflation boom	
10yr	2.0%
ERP	2.4%
disc rate	4.4%
EPS	8%
Fair Value	32.5
deflation bust	
10yr	1.0%
ERP	4.0%
disc rate	5.0%
EPS	-10%
Fair Value	12.5
Muddle Through	
10yr	2.2%
ERP	3.5%
disc rate	5.7%
EPS	3%
Fair Value	20.0

Discounted Earnings Model

5yr EPS growth

discount rate (10yr + risk premium)	-10%	-9%	-8%	-7%	-6%	-5%	-4%	-3%	-2%	-1%	**0%**	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
3.5%	17.6	18.5	19.4	20.4	21.4	22.5	23.6	24.8	26.0	27.3	28.6	29.9	31.3	32.8	34.3	35.9	37.6	39.3	41.0	42.9	44.8	46.7	48.8	50.9	53.1	55.3	57.7	60.1	62.6	65.2	67.8
3.6%	17.1	18.0	18.9	19.9	20.9	21.9	23.0	24.1	25.3	26.5	27.8	29.1	30.5	31.9	33.4	34.9	36.5	38.2	39.9	41.7	43.5	45.4	47.4	49.4	51.5	53.7	56.0	58.3	60.8	63.3	65.9
3.7%	16.6	17.5	18.4	19.3	20.3	21.3	22.4	23.5	24.6	25.8	27.0	28.3	29.6	31.0	32.5	34.0	35.5	37.1	38.8	40.5	42.3	44.1	46.1	48.0	50.1	52.2	54.4	56.7	59.1	61.5	64.0
3.8%	16.2	17.1	17.9	18.8	19.8	20.8	21.8	22.9	24.0	25.1	26.3	27.6	28.9	30.2	31.6	33.0	34.6	36.1	37.7	39.4	41.1	42.9	44.8	46.7	48.7	50.8	52.9	55.1	57.4	59.8	62.2
3.9%	15.8	16.6	17.5	18.4	19.3	20.2	21.2	22.3	23.4	24.5	25.6	26.9	28.1	29.4	30.8	32.2	33.7	35.2	36.7	38.4	40.1	41.8	43.6	45.5	47.4	49.4	51.5	53.7	55.9	58.2	60.6
4.0%	15.4	16.2	17.1	17.9	18.8	19.7	20.7	21.7	22.8	23.9	25.0	26.2	27.4	28.7	30.0	31.4	32.8	34.3	35.8	37.4	39.0	40.7	42.5	44.3	46.2	48.2	50.2	52.3	54.4	56.7	59.0
4.1%	15.1	15.9	16.7	17.5	18.4	19.3	20.2	21.2	22.2	23.3	24.4	25.5	26.7	28.0	29.3	30.6	32.0	33.4	34.9	36.4	38.0	39.7	41.4	43.2	45.0	46.9	48.9	50.9	53.0	55.2	57.5
4.2%	14.7	15.5	16.3	17.1	17.9	18.8	19.7	20.7	21.7	22.7	23.8	24.9	26.1	27.3	28.6	29.9	31.2	32.6	34.1	35.6	37.1	38.7	40.4	42.1	43.9	45.8	47.7	49.7	51.7	53.8	56.0
4.3%	14.4	15.1	15.9	16.7	17.5	18.4	19.3	20.2	21.2	22.2	23.3	24.3	25.5	26.7	27.9	29.1	30.5	31.8	33.2	34.7	36.2	37.8	39.4	41.1	42.9	44.7	46.5	48.5	50.5	52.5	54.6
4.4%	14.1	14.8	15.6	16.3	17.1	18.0	18.9	19.8	20.7	21.7	22.7	23.8	24.9	26.0	27.2	28.5	29.8	31.1	32.5	33.9	35.4	36.9	38.5	40.1	41.8	43.6	45.4	47.3	49.3	51.3	53.3
4.5%	13.8	14.5	15.2	16.0	16.8	17.6	18.4	19.3	20.3	21.2	22.2	23.3	24.3	25.5	26.6	27.8	29.1	30.4	31.7	33.1	34.6	36.1	37.6	39.2	40.9	42.6	44.4	46.2	48.1	50.1	52.1
4.6%	13.5	14.2	14.9	15.6	16.4	17.2	18.0	18.9	19.8	20.8	21.7	22.8	23.8	24.9	26.0	27.2	28.4	29.7	31.0	32.4	33.8	35.3	36.8	38.3	39.9	41.6	43.4	45.1	47.0	48.9	50.9
4.7%	13.2	13.9	14.6	15.3	16.1	16.9	17.7	18.5	19.4	20.3	21.3	22.3	23.3	24.4	25.5	26.6	27.8	29.1	30.3	31.7	33.0	34.5	36.0	37.5	39.1	40.7	42.4	44.1	45.9	47.8	49.7
4.8%	13.0	13.6	14.3	15.0	15.7	16.5	17.3	18.1	19.0	19.9	20.8	21.8	22.8	23.9	24.9	26.1	27.2	28.4	29.7	31.0	32.3	33.7	35.2	36.7	38.2	39.8	41.5	43.2	44.9	46.8	48.7
4.9%	12.7	13.4	14.0	14.7	15.4	16.2	17.0	17.8	18.6	19.5	20.4	21.4	22.3	23.4	24.4	25.5	26.7	27.8	29.1	30.3	31.7	33.0	34.4	35.9	37.4	39.0	40.6	42.2	44.0	45.8	47.6
5.0%	12.5	13.1	13.8	14.4	15.1	15.9	16.6	17.4	18.2	19.1	20.0	20.9	21.9	22.9	23.9	25.0	26.1	27.3	28.5	29.7	31.0	32.3	33.7	35.1	36.6	38.1	39.7	41.4	43.0	44.8	46.6
5.1%	12.2	12.9	13.5	14.2	14.8	15.6	16.3	17.1	17.9	18.7	19.6	20.5	21.5	22.4	23.4	24.5	25.6	26.7	27.9	29.1	30.4	31.7	33.0	34.4	35.9	37.4	38.9	40.5	42.2	43.9	45.6
5.2%	12.0	12.6	13.2	13.9	14.6	15.3	16.0	16.8	17.6	18.4	19.2	20.1	21.0	22.0	23.0	24.0	25.1	26.2	27.3	28.5	29.8	31.0	32.4	33.7	35.1	36.6	38.1	39.7	41.3	43.0	44.7
5.3%	11.8	12.4	13.0	13.6	14.3	15.0	15.7	16.5	17.2	18.0	18.9	19.7	20.6	21.6	22.5	23.6	24.6	25.7	26.8	28.0	29.2	30.4	31.7	33.1	34.4	35.9	37.4	38.9	40.5	42.1	43.8
5.4%	11.6	12.2	12.8	13.4	14.0	14.7	15.4	16.1	16.9	17.7	18.5	19.4	20.3	21.2	22.1	23.1	24.1	25.2	26.3	27.4	28.6	29.8	31.1	32.4	33.8	35.2	36.6	38.1	39.7	41.3	42.9
5.5%	11.4	12.0	12.5	13.2	13.8	14.5	15.1	15.9	16.6	17.4	18.2	19.0	19.9	20.8	21.7	22.7	23.7	24.7	25.8	26.9	28.1	29.3	30.5	31.8	33.1	34.5	35.9	37.4	38.9	40.5	42.1
5.6%	11.2	11.8	12.3	12.9	13.6	14.2	14.9	15.6	16.3	17.1	17.9	18.7	19.5	20.4	21.3	22.3	23.3	24.3	25.3	26.4	27.6	28.7	30.0	31.2	32.5	33.9	35.2	36.7	38.2	39.7	41.3
5.7%	11.0	11.6	12.1	12.7	13.3	14.0	14.6	15.3	16.0	16.8	17.5	18.3	19.2	20.0	20.9	21.9	22.8	23.8	24.9	25.9	27.1	28.2	29.4	30.6	31.9	33.2	34.6	36.0	37.5	39.0	40.5
5.8%	10.8	11.4	11.9	12.5	13.1	13.7	14.4	15.1	15.8	16.5	17.2	18.0	18.8	19.7	20.6	21.5	22.4	23.4	24.4	25.5	26.6	27.7	28.9	30.1	31.3	32.6	34.0	35.3	36.8	38.3	39.8
5.9%	10.7	11.2	11.7	12.3	12.9	13.5	14.1	14.8	15.5	16.2	16.9	17.7	18.5	19.4	20.2	21.1	22.0	23.0	24.0	25.0	26.1	27.2	28.4	29.5	30.8	32.0	33.4	34.7	36.1	37.6	39.1
6.0%	10.5	11.0	11.5	12.1	12.7	13.3	13.9	14.6	15.2	15.9	16.7	17.4	18.2	19.0	19.9	20.8	21.7	22.6	23.6	24.6	25.7	26.7	27.9	29.0	30.2	31.5	32.8	34.1	35.5	36.9	38.4
6.1%	10.3	10.8	11.4	11.9	12.5	13.1	13.7	14.3	15.0	15.7	16.4	17.1	17.9	18.7	19.5	20.4	21.3	22.2	23.2	24.2	25.2	26.3	27.4	28.5	29.7	30.9	32.2	33.5	34.8	36.2	37.7
6.2%	10.2	10.7	11.2	11.7	12.3	12.9	13.5	14.1	14.7	15.4	16.1	16.9	17.6	18.4	19.2	20.1	20.9	21.9	22.8	23.8	24.8	25.8	26.9	28.0	29.2	30.4	31.6	32.9	34.2	35.6	37.0
6.3%	10.0	10.5	11.0	11.5	12.1	12.7	13.3	13.9	14.5	15.2	15.9	16.6	17.3	18.1	18.9	19.7	20.6	21.5	22.4	23.4	24.4	25.4	26.5	27.6	28.7	29.9	31.1	32.4	33.7	35.0	36.4
6.4%	9.9	10.4	10.9	11.4	11.9	12.5	13.1	13.7	14.3	14.9	15.6	16.3	17.1	17.8	18.6	19.4	20.3	21.2	22.1	23.0	24.0	25.0	26.0	27.1	28.2	29.4	30.6	31.8	33.1	34.4	35.8
6.5%	9.7	10.2	10.7	11.2	11.7	12.3	12.9	13.5	14.1	14.7	15.4	16.1	16.8	17.5	18.3	19.1	20.0	20.8	21.7	22.6	23.6	24.6	25.6	26.7	27.8	28.9	30.1	31.3	32.6	33.9	35.2
6.6%	9.6	10.1	10.5	11.0	11.6	12.1	12.7	13.3	13.9	14.5	15.2	15.8	16.5	17.3	18.0	18.8	19.6	20.5	21.4	22.3	23.2	24.2	25.2	26.3	27.3	28.5	29.6	30.8	32.0	33.3	34.6
6.7%	9.5	9.9	10.4	10.9	11.4	11.9	12.5	13.1	13.7	14.3	14.9	15.6	16.3	17.0	17.8	18.5	19.3	20.2	21.0	21.9	22.9	23.8	24.8	25.8	26.9	28.0	29.1	30.3	31.5	32.8	34.1
6.8%	9.3	9.8	10.2	10.7	11.2	11.8	12.3	12.9	13.5	14.1	14.7	15.4	16.1	16.8	17.5	18.3	19.1	19.9	20.7	21.6	22.5	23.5	24.4	25.4	26.5	27.6	28.7	29.8	31.0	32.3	33.5
6.9%	9.2	9.6	10.1	10.6	11.1	11.6	12.1	12.7	13.3	13.9	14.5	15.1	15.8	16.5	17.2	18.0	18.8	19.6	20.4	21.3	22.2	23.1	24.1	25.1	26.1	27.1	28.2	29.4	30.5	31.8	33.0
7.0%	9.1	9.5	10.0	10.4	10.9	11.4	12.0	12.5	13.1	13.7	14.3	14.9	15.6	16.3	17.0	17.7	18.5	19.3	20.1	21.0	21.8	22.8	23.7	24.7	25.7	26.7	27.8	28.9	30.1	31.3	32.5
7.1%	9.0	9.4	9.8	10.3	10.8	11.3	11.8	12.3	12.9	13.5	14.1	14.7	15.4	16.0	16.7	17.5	18.2	19.0	19.8	20.7	21.5	22.4	23.3	24.3	25.3	26.3	27.4	28.5	29.6	30.8	32.0
7.2%	8.8	9.3	9.7	10.2	10.6	11.1	11.6	12.2	12.7	13.3	13.9	14.5	15.1	15.8	16.5	17.2	18.0	18.7	19.5	20.4	21.2	22.1	23.0	23.9	24.9	25.9	27.0	28.1	29.2	30.3	31.5
7.3%	8.7	9.1	9.6	10.0	10.5	11.0	11.5	12.0	12.5	13.1	13.7	14.3	14.9	15.6	16.3	17.0	17.7	18.5	19.3	20.1	20.9	21.8	22.7	23.6	24.6	25.6	26.6	27.6	28.7	29.9	31.0
7.4%	8.6	9.0	9.5	9.9	10.4	10.8	11.3	11.8	12.4	12.9	13.5	14.1	14.7	15.4	16.1	16.7	17.5	18.2	19.0	19.8	20.6	21.5	22.3	23.3	24.2	25.2	26.2	27.2	28.3	29.4	30.6
7.5%	8.5	8.9	9.3	9.8	10.2	10.7	11.2	11.7	12.2	12.8	13.3	13.9	14.5	15.2	15.8	16.5	17.2	18.0	18.7	19.5	20.3	21.2	22.0	22.9	23.9	24.8	25.8	26.9	27.9	29.0	30.1

Data source: FMR, Bloomberg, Haver Analytics, FactSet. Monthly data as of 10/27/2015.

So I don’t think the market has a valuation problem. There’s an earnings problem. There’s not enough earnings. But I think that’s a special situation because of energy. And it does have very low interest rates, which, of course, is how you discount forward earnings if you’re using a discounted cash flow type of model. And so if interest rates rise, you could make the argument that, all else being equal, the valuation has to come down. And that’s true if earnings were not moving in that scenario. And if that’s the case -- so let’s say the 10-year yield goes from two to three and a half, and there’s no pickup in earnings growth, then at 18 times earnings, the stock market is about four points overvalued, and it should go down to 14. But I don’t think that’s how it would play out because I don’t think the 10-year yield is going to be able to go to three and a half from two, unless there’s a significantly stronger economy to go with that. And if the economy gets stronger, then earnings are going to get stronger, and then you’re going to get better earnings growth. And if you feed that into this discounted earnings model, then the -- whatever you lose on -- from the fact that rates are rising, you gain from the fact that earnings are accelerating. And then you're still back into this sort of 18 times earnings mode.

So the way I look at it, there's not really a valuation problem in the stock market. We just have too little earnings, and that comes from the fallen energy prices and from just a lack of economic growth around the world. And that lack of growth is, in part, the result of too much debt. And as I showed at the beginning, that too much debt comes -- you know, is being worked through, but it's sort of one phase at a time. And the current phase, if you will, the current front line in that wave of deleveraging is now China and emerging markets, and that's why China is in the news so much, and that's why it's so important to see how China resolves or transitions through this period. So the US took its medicine in '08. Europe took its medicine a couple years ago and is still taking it. And now it's China and emerging markets, and that's why we are where we are. So with that, why don't I end it here, and I'll turn it back over to Al.

Al Buatti: Thank you, Jurrien. Really helpful conversation. I want to go right to the questions. We've had a number of them come in over the phone and over the web. And let's stay with China. Seems to be the big story of the day. I'm going to try to pin together a few different aspects of questions that we're hearing from the field. The first is around the short-term growth forecast for China. If you had to summarize, is it bad or worse than what's been communicated? Those are words coming in directly from the web. But also, we're getting questions about the shifts in manufacturing from China to the US, how big that shift is, and is that contributing to the slower economic growth in China?

Jurrien Timmer: Well, those are great questions. So first of all, the first one is easy, because the official data that had been reported and continue to be reported are for -- that growth is running at about 7%. And from the data that I'm seeing, you know, like real-time data, like freight shipments, and railroad car loadings, and electricity usage, and things like that, I don't get 7%. I get something like 2 or 3 or 4%. So I think the official data are inflated and, you know, I'm not going to get into why that is but, you know, from what I'm seeing, the numbers are weaker. They're growing but they're growing, you know, kind of at the same rate that the rest of the world is growing, basically. And of course, China is transitioning from an investment- led -- you know, it used to be the factory of the world and it no longer is, you know, and it shouldn't be, if it's trying to transition to more of a domestic consumption economy. You know, in the US, domestic consumption is 71% of GDP. In a country like Indonesia, it's 60 or 65%. But in China, it's only 30 to 35%. So they need to sort of, you know, shift to that model. But you can't go to a model like that and grow 7%. They don't go together. So they growth they had was really not sustainable and -- nor should anyone expect that it is, because eventually, the laws of large numbers just take over, and you become a huge economy. You know, if you're growing at 7 to 10% a year for two decades, you know, eventually, you're going to get huge, and you can't mathematically keep growing at that rate. And in the process of China becoming more industrialized and creating more of a middle class, of course, their wages go up to the point where they're no longer as competitive as they used to be, and that labor arbitrage of companies outsourcing jobs to China doesn't really work anymore. And that really hasn't worked in a while. You know, those jobs already went to Vietnam, and Malaysia, and the Philippines, and other places. And so China is becoming a more advanced, industrialized country, which I think is exactly what it should be doing, and what their policymakers always envisioned that they would do. But the transition from one model to another model doesn't come without bumps, and the fact that they have tied their currency to the US dollar, I think, has created some issues, because the currency over there, the RMB, or the yuan, as it's called, is overvalued and, you know, it needs to come down. And I think their big task over there is how to manage that. Do they do one big devaluation and call it a day, or do they just try to maintain that value over time and maybe do little devaluations once in a while? China's also trying to join the IMS SDR, the special drawing rights. It's trying to become a global reserve currency. And, you know, you need to kind of have an open capital system and a free-floating currency to be a contender for that honor. And I think that's another reason why they devalued. So they have some challenges, but so far, they seem to be managing it reasonably well. But that's why a lot of what we're looking at has to do with China these days.

Thank you. Jurrien, can we talk further about oil and the connection of oil to emerging markets, and also, what you see -- what your outlook is for the next 12 to 24 months in terms of the price of energy?

Jurrien Timmer: Yeah. So whenever we talk about commodities, there's a demand side and there's a supply side. And, you know, when you look at the agricultural commodities, this is always a big issue, right? The weather plays a huge role, etc. The same is true for energy, or industrial metals, or really, any commodity -- really, any asset, but especially in commodities. And so what we had happen in oil was sort of a double whammy that, on the one hand, demand started to fall because China slowed. And as China's economy slows, and China has been the marginal consumer of commodities for -- you know, for many years, as it started to -- as it really industrialized at a very rapid pace -- as it slows down its consumption of commodities -- and I'm not talking just about oil, but also, copper, and iron ore, and, you know, coal, and all these other commodities -- the countries that sell those commodities and export them to China, like Australia, Brazil, Canada, obviously, they all suffer along with it. And commodities tend to work with very long cycles, so, you know, you don't create and open up a copper mine overnight. It takes years. You know, you have to find the stuff and you have to build the mine. This takes a lot of time and a lot of money. And then what happens is, just as you -- you know, every -- it's like real estate, right? Everybody decides to build buildings at the same time, and then, a few -- five years later or three years later, all the buildings are done, right as the cycle starts to turn, and then you have a bunch of empty buildings.

And so we had the same thing with the copper mines and even with some of these oil -- new oil resources —shale is one of them — the Canadian oil sands, deep water, sub-salt, all of these, you know, kind of unconventional sources of oil, those were all being brought online as the demand for oil seemed to be ever-growing and insatiable from China. And then, you know, we developed all this new capacity. And then, at the same time, China peaked and started to slow, and so we had less demand meeting more supply. And the problem, of course, with oil, is that these unconventional sources all require high oil prices because they have very high costs of production. So in shale, for instance, I think the cost of production is maybe $65 a barrel, although that's coming down as technology improves. But other areas in the world, like subsalt and deep water, are maybe at 75, or the Canadian oil sands, I think, are at 75. So when oil goes to 50 or 40, these projects are all under water, and they stop drilling. And so this is where the supply response comes in. And normally, supply response would be very abrupt. So they shut everything down and they wait for oil prices to come back.

But this time we have a different -- an interesting dynamic, because, you know, it used to be that the oil business was run by OPEC and they had a cartel, a monopoly, and they would set the price. So if prices were too high, you know, they would respond, and if the demand would go down, they would respond by cutting production. But this time, oil prices came down as demand slowed from China and new supply was coming on from these unconventional sources, and OPEC decided not to cut production. And apparently, the reason for that is that they, obviously, are threatened that they actually have to compete, for a change, to sell oil in an open market, as opposed to a monopoly. And so they kept production going to try to force the unconventional sources of oil out of business, knowing that the cost of production, or the break-evens in OPEC are far lower, like $35 a barrel, than they are for the nonconventional. So there's also kind of a political aspect to this, where OPEC is trying to put the squeeze on the nonconventional sources.

So the bottom line is that the world oil market is oversupplied by maybe two million barrels a day, and it will take probably another 6 to 12 months to work off that oversupply, and then we'll be back in balance. And if China is improving by then, we'll get one and a half, two million barrels a day of new demand growth from just the global economy expanding. And we have depletion rates that are running at about six, seven million barrels a day. So at some point, the oil market will be back in balance. We'll go back to the fifties and sixties, maybe even the seventies. I don't see it going much higher than that because there's about a thousand rigs that were pulled out of the ground in the US that can go back in very, very quickly. And the thing about shale is that, you know, you can turn the tap on, and 30 days later, you're pumping oil again. So the supply response, if demand picks up, and oil prices go up, will be relatively swift this time around, whereas in the past, they would be slower. So I don't see a tremendous amount of upside, but I don't see, really, any further downside here, either.

Al Buatti: Thank you, Jurrien. We have time for one more question here. Let's come back to the US. We have a lot of clients asking these days about the healthcare sector and, in particular, the biotech industry. Can you comment on the prospects for both, and perhaps, maybe your thoughts in terms of the current presidential election cycle and, you know, what role comments from candidates are playing in the performance of those two areas?

Jurrien Timmer: Yeah. So obviously, as we all know, in August, when we had the market correction, and then we had the recovery starting just a few weeks ago, that unleashed a very violent sort of rotation out of the -- what I would call the secular growth story, so biotech, tech, healthcare. And by secular growth, I mean these are companies that are going to grow earnings at a very healthy clip, regardless of what the economy does. So if you're a biotech company, you know, creating a new drug or a new cure for some disease, it doesn't really matter whether the economy's growing at 2% or 5%. You know, that's going to be a big win. So these are what I call secular growth stories that do not really on the economic cycle, and therefore, they're not really sensitive, like I showed you in that heat map with the valuation. They're not really sensitive what happens to interest rates because, you know, if you're growing earnings at 5% and you're -- the discount rate that you're valuing your earnings at goes from two to four, you know, that makes a big difference. But if you're growing your earnings at 20%, it really doesn't matter.

So for the last couple of years, that area has been hot because the economy has not been growing very rapidly, so investors look to stories, companies that can grow, regardless of the economic cycle. And then that goes at the expense of what we call deep cyclicals, like energy, materials, mining, industrials, companies that are tied to the global economic cycle and that are especially tied to China which, of course, oil prices and, you know, the manufacturers of capital goods, and tractors, and all that kind of stuff, and cranes -- you know, those are all tied to the overall economic cycle. So what we had coming off of the bottom a few weeks ago was a big rotation because those deep cyclicals were so bombed out, they were so low the P/Es were so low that, essentially, you got a rotation in and, you know, we're living in a world where a lot of players are in the same [stock?], so there's -- I think there's 10,000 hedge funds out there, and they're basically all doing the same thing.

You know, they're looking for these companies that are growing and they're shorting companies that are not. And so we had this in '08. We had this 2000. So you get these reversion -- these mean-reverting trades where, all of a sudden, everyone goes from one side of the ship to the other, and then all these levered players have to follow through because they get margin calls. So we've seen a very violent rotation. The question is, what happens next? And for me, it comes down to a pretty fairly elementary thing, which is that in order for the secular growers to continue losing ground versus the deep cyclicals, you need one of two things: you need -- either need the economy to get out of this funk and start growing, not at 2%, but at 3 or 4%, so you need a real acceleration in economic growth, and then it brings all these devalue, these cyclicals up, because then energy is doing well, materials are doing better, industrials are doing better, and there's no longer a need to, then, pay up for these secular growers, like the biotech, and the tech, and the healthcare, because you can find much better deals at much better prices, basically.

So one way to get out of -- for this to continue, this mean reversion to continue, is for economic growth to accelerate. And I don't really see that happening here. I just don't see any evidence of that happening.

The other way it could happen is if the Fed were to do QE4 and would inject, you know, maybe -- let's say a trillion dollars of brand new, printed money into the system, then you got another big reflation trade. That knocks the dollar down, and as the dollar goes down, oil goes up. China does better, EM does better, because they all need the dollar to go down to be able to grow better. And then I think you also see the scenario where the cyclicals, you know, overtake the secular growers. But I think the notion of QE4 is -- or the prospect of QE4, I think, is very, very low at this point. I mean, the Fed is desperately trying to raise rates, let alone, print more money. So I don't really see that happening on the horizon, either. So when I look at the two scenarios, I see neither of them happening, which tells me that, probably, the secular growth names, or that theme, will start to pick up again, once the older margin calls have taken place.

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Sources for correlation slide: All data downloaded from Haver Analytics. All country and regional equity indices: MSCI. All bond indices: Barclays Capital. Gold: Handy & Harman. All GSCI: Goldman Sachs Commodity Index. Currencies: Morgan Stanley. Hedge Fund Data: HFRX.

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It is not possible to invest directly in an index. P/E – Price to Earnings Ratio

YOY YR – Year over year Total Return

Z Scores – A Z-Score is a statistical measurement of a score's relationship to the mean in a group of scores. A Z-score of 0 means the score is the same as the mean. A Z-score can also be positive or negative, indicating whether it is above or below the mean and by how many standard deviations.

EPS Est NTM – Earnings per share estimates

QE of the Fed, ECB, PBoC, BoE, BoJ and SNB- Quantitative easing of the Federal Reserve, European Central Bank, People's Bank of China, Bank of England, Bank of Japan and Swiss National Bank

Fwd P/E – Forward price to earnings, net to month

Fed Funds rate is the rate of interest on overnight loans of excess reserves among commercial banks.

Bonds are rated by agencies such as Standard & Poor's and Moody's Investor Services with ratings that measure the risk of default. Bonds rated AAA are considered to be the safest while those rated below BBB are considered to be “high yield” or below investment grade. Intermediate ratings of AA+ or BB- are often used to further differentiate bonds.

30-year treasury and 10 year treasury are a fixed income securities backed by the full faith and credit of the U.S. government and are used as benchmarks for the pricing of various corporate fixed income instruments.

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Sources for correlation slide:

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