Global growth divergence in 2015

Rick Lacaille | State Street Global Advisors | 10 February 2015

FIVE INVESTMENT THEMES FOR 2015

Getting the big one right – Long periods of low volatility may have left investors complacent, but with equity indices at all-time highs and bond yields at all-time lows, risk aversion has spiked sharply upwards. What happens next?

Shifting gears in a two-speed market – Improving economic and earnings environments bring opportunities, even in expensive markets. Locating value even as diverging interest rates reshape the landscape can unearth upside possibilities.

What emerging markets reform can deliver – Investors sifting developing markets for opportunities are favouring those countries where reforms are on the agenda. We look at why the reformers are the performers.

It's all relative – Sovereign rate differentials between regions with loosening central bank monetary policy and those in tightening mode will continue to provide some of the biggest opportunities for fixed income investors in 2015.

The macro is not the market – Europe’s structural problems are legion and well known. But tailwinds are also rising. We map Europe’s pockets of value.

1. 2014 IN RETROSPECT

Investors were reminded in 2014 that financial markets rarely run a smooth course. With the US economy gathering momentum and Europe relying on ECB action to progress, a theme of divergence will feature strongly in 2015. Overall, we expect the economic pick-up predicted in 2014 to now materialise in 2015. However, there are risks to the downside and investors may need to think a little smarter and look a little harder when ivnesting in the coming year.

There was plenty for investors to digest in 2014. In a year that stubbornly refused to unfold along predicted lines, there were moments that caused many to pause and reassess. It proved to be a year that confounded the consensus expectation from the off and ended with the US effectively de-coupling from much of the rest of the world.

Widely expected to hit the year running, the US instead faltered at the first hurdle as weather disruptions caused Gross Domestic Product (GDP) to contract by more than 2%. Throw in a eurozone recovery that faltered prematurely, a Japanese economy that went into reverse after a sales tax hike, and those of an optimistic persuasion were on the back foot from early on.

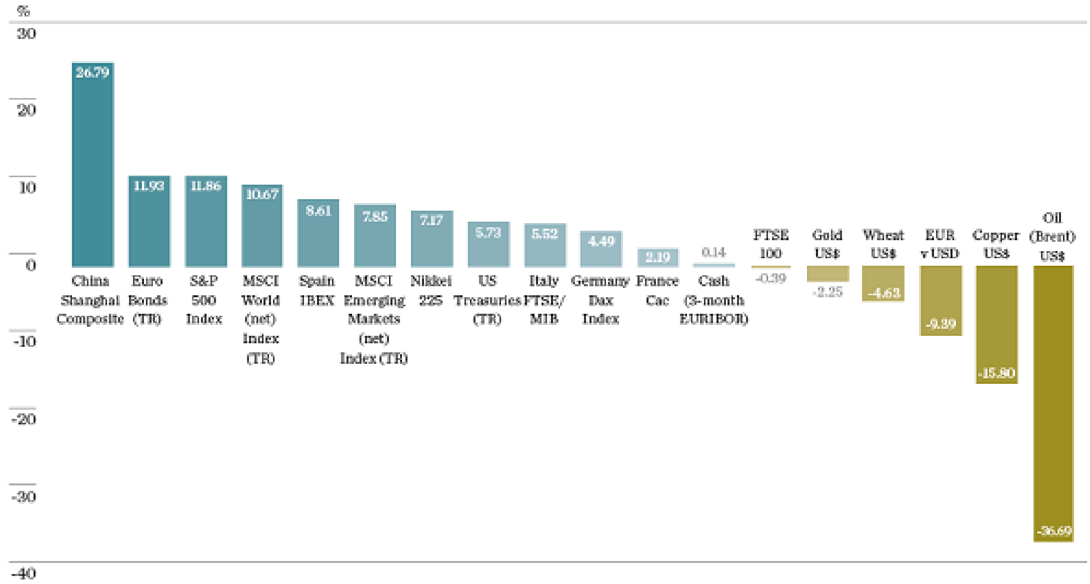
A shifting geopolitical landscape became an unexpectedly central feature of the year. The startling pace at which ISIS militants grabbed territory served to illustrate just how quickly the terrain can change. Tensions in Ukraine surged as Russia annexed Crimea and provided support for east Ukraine separatists, something that did not play well in the US or Europe; subsequent tit-for-tat sanctions ensured that the economic impact was felt beyond the disputed borders.

1.1. Diverging Returns

Unsettled by weak economic data and rising geopolitical tensions, investors sought greater security and the 2013 trend towards higher bond yields was broken. Eurozone bond yields, of both the core and the periphery, dropped to record lows as the threat of a triple-dip raised expectation that the European Central Bank (ECB) would ease monetary policy, which it duly did.

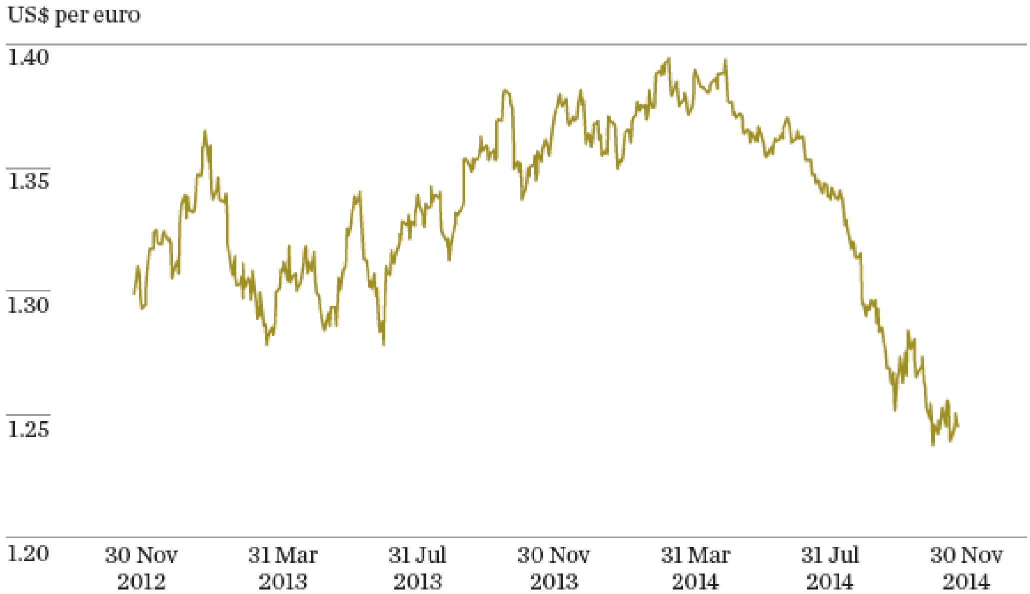
Meanwhile, many stock markets saw advances that were buoyed by effervescent corporate profitability levels, although a spike in volatility in October threatened to vanquish gains. There were significant performance differentials by stock, sector and country through 2014 – investors were selective, and cautious with it, wherever they operated.

Figure 1: Returns for 2014 (Year to Date)



Sources: Bloomberg, MSCI, Bank of America Merrill Lynch as of 28 November 2014. All returns are on a capital only basis, in local currency terms except where stated. Past performance is not a guarantee of future results. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income, gain and loss and the reinvestment of dividends net of withholding taxes and other income.

Figure 2: Euro slides against resurgent US Dollar



Source: Bloomberg as of 28 November 2014. The information contained above is for illustrative purposes only.

Overall, the global economy disappointed in 2014. But why? The upbeat growth predictions for the United States, Europe and Japan stumbled, set off course by harsh weather, geopolitical rumblings, and unexpectedly large household and corporate reactions. Consequently, the year proved to be little more than a re-run of 2013 in terms of growth.

1.2 More Than One Statistic

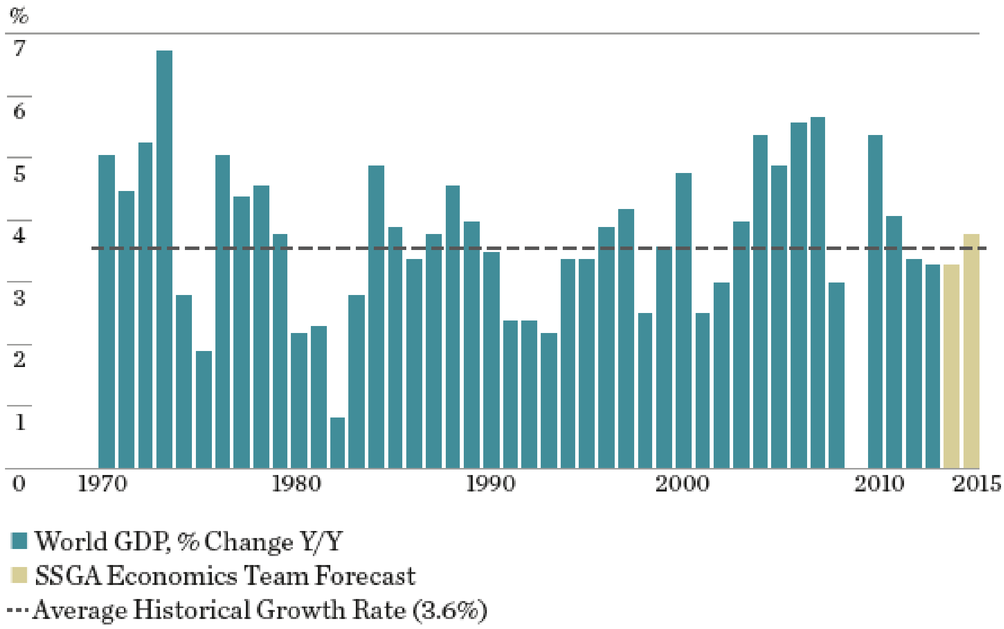
But reducing the year to a single statistic masks important developments on relative performance and economic policy. The US, eurozone and Japan all lost momentum during the first half of 2014. But the US has bounced back robustly, allowing the Federal Reserve ('the Fed') to end bond purchases, while the eurozone and Japan are struggling to regain impetus, obliging both the ECB and the Bank of Japan (BoJ) to ease. Indeed, economic performance and monetary policy began to de-couple in the second half of the year, which manifested itself across a number of asset classes, but most obviously in the foreign exchange market.

2. 2015 IN PROSPECT

Global growth should accelerate on improvements in both the advanced and developing economies in 2015. Within the former, the US, Europe and Japan should all enjoy somewhat stronger growth, although the extent of each region's contribution will vary. The large advanced economies will continue to de-couple in 2015, with growth accelerating to around 3.0% in the US, while languishing near 1.0% in both the eurozone and Japan.

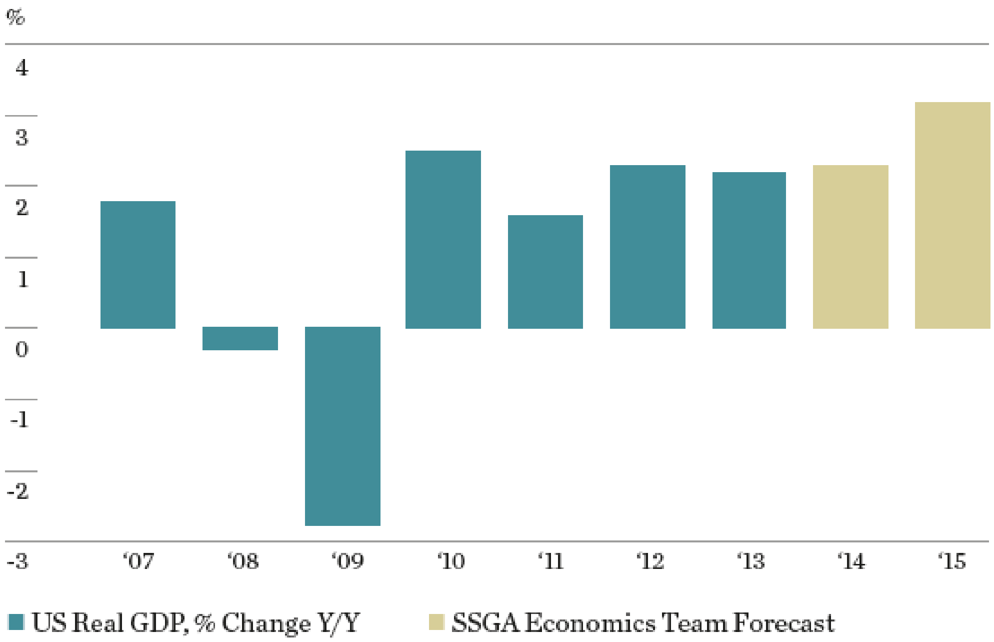
Emerging markets will be more reliant on the likes of the US to fuel growth in the coming year, even as growth in EM continues to outpace developed markets at a headline level. Overall, emerging economies are likely to enjoy a modest acceleration in growth, notwithstanding risks that are skewed to the downside.

Figure 3: Global growth to pick up in 2015



Sources: International Monetary Fund (IMF), State Street Global Advisors (SSGA) Economics Team. As of 28 November 2014. The above forecasts are estimates based on certain assumptions and analysis made by the SSGA Economics Team. There is no guarantee that the estimates will be achieved.

Figure 4: US economy gathering momentum



Sources: Oxford Economics, SSGA Economics Team. As of 28 November 2014. The above forecasts are estimates based on certain assumptions and analysis made by the SSGA Economics Team. There is no guarantee that the estimates will be achieved.

2.1 The Real Global Growth Engine - United States

There are substantial grounds for optimism about America's prospects:

- **Fiscal drag** (government spending cuts and/or tax increases) that hinders economic growth will be further reduced in 2015.
- **Household fundamentals are sound**; while wage growth remains anaemic, consumer confidence has improved and balance sheets have been repaired amid falling unemployment and rising equity and home prices.
- **Capital expenditure regained momentum** in the second quarter of 2014, and new orders — a leading indicator of capital spending — continue to trend higher.
- **The trade deficit has narrowed** as energy imports have fallen while overall exports have continued to grow.

Admittedly, residential construction continues to lag, but with the economy firing on all the other cylinders, growth appears poised to accelerate to 3.2% from the lacklustre 2.0% that has defined the recovery so far. Recent data has offered encouragement - the finalised GDP growth reading of 4.6% for Q2 outstripped consensus expectations and while the third quarter was always going to struggle to match that pace, the reported expansion of 3.9% topped forecasts and firms up expectations for 2015.

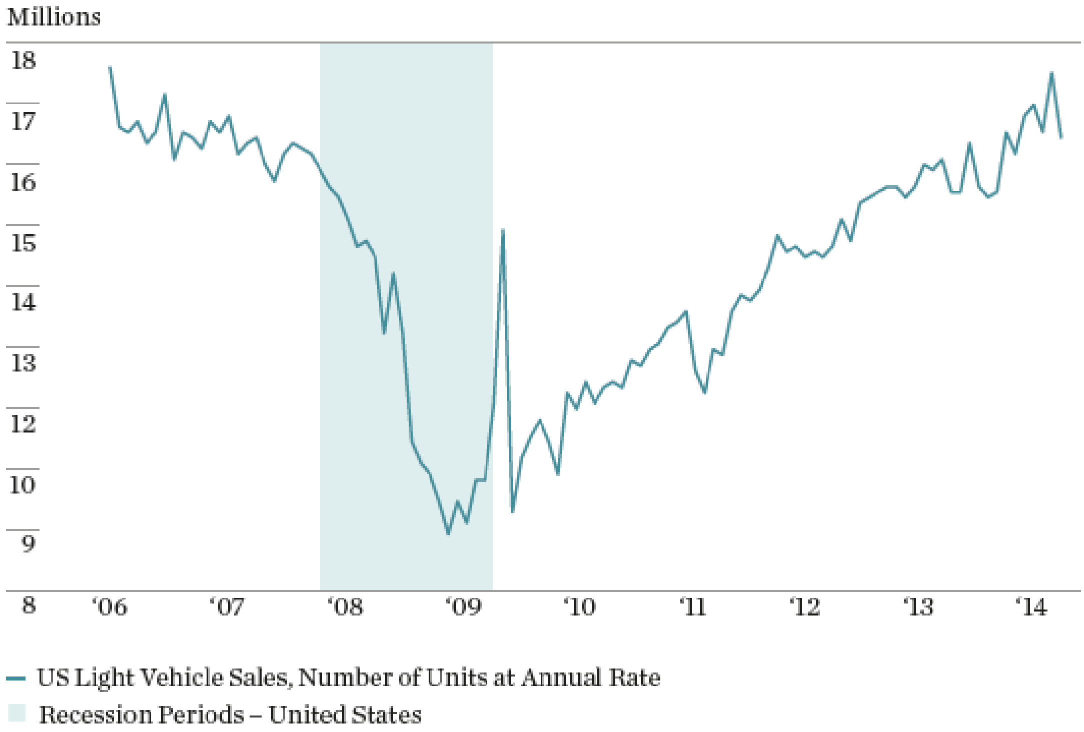
2.2 The Consumer is (always) the Key

Consumer spending accounts for about two-thirds of US GDP, so sluggish wage growth, depressed confidence and deleveraging associated with balance sheet repair represented a considerable headwind for the economy in the early stages of the recovery. That has changed and car sales — an important indicator of consumer financial health and confidence — are now back at pre-recession levels. And what is perhaps even more impressive is that auto companies are reaching these sales levels without employing the type of incentives that featured in prerecession times.

2.3 On the Move - the Fed in 2015

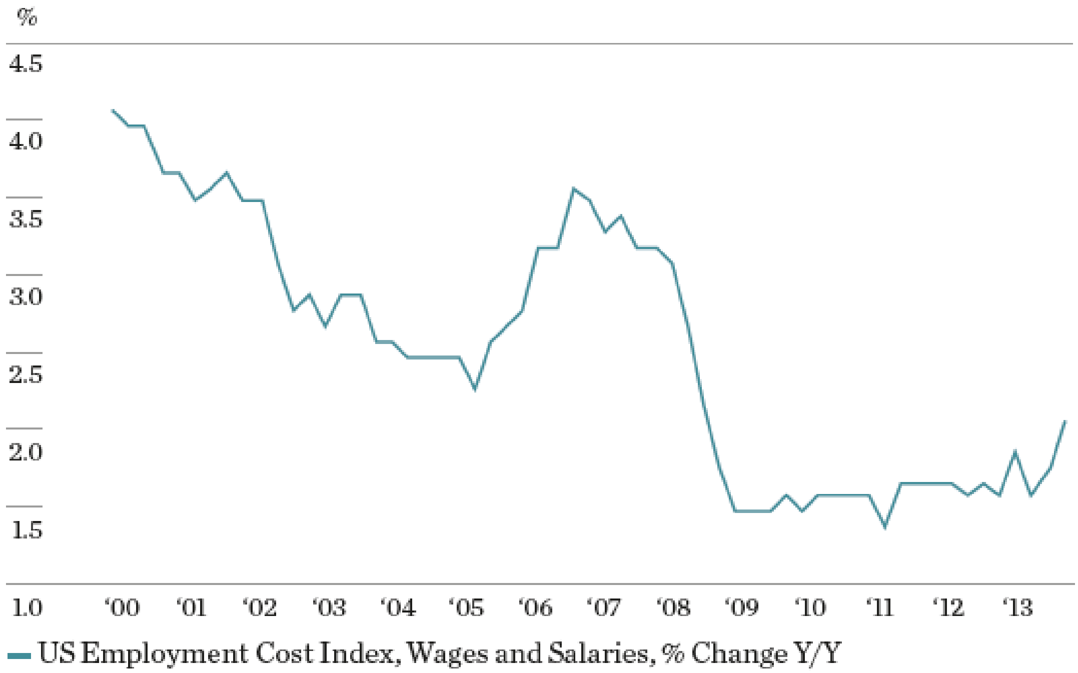
When the Fed ended its asset purchase program in October, we officially entered 'the considerable period of time' before the first rate hike. Based on comments by Chairman Yellen, considerable period equates to about six months, which suggests a mid-2015 start. But, the 'lift-off', and subsequent speed of tightening will be data dependent: the better the economy, the sooner the lift-off and steeper the trajectory; the worse the economy, the later the lift-off and flatter the trajectory. It is worth keeping an eye on the Fed's dot chart to get a sense of thinking within the Fed. There are clearly diverging opinions on when the Fed might reach its longer run target level for the federal funds rate.

Figure 5: Consumers hit the showrooms



Sources: Dept of Commerce & National Bureau of Economic Research. As of 28 Nov 2014.

Figure 6: Little threat in inflation data



Sources: Bureau of Labor Statistics As of 28 November 2014.

2.4 Inflation at Bay

Subscribers to a quicker tightening scenario have been labelled 'inflationistas', who worry that the scale of accommodation to date could bring about a racier pace of inflation than commonly expected. But, these threats appear exaggerated.

In the first instance, there are few signs of upward pressure on wage rates, even with a headline unemployment rate that has fallen below 6.0%. This gives some credence to Yellen's stated belief that there is greater slack in the labour market than the headline jobless number might suggest. Moreover, even if it is painting an accurate picture, there were two periods in the last 15 years when the unemployment rate was close to 4% without an accompanying spike in inflation. Hence, it seems the Fed is right to maintain a slow and gradual approach towards monetary tightening.

As the above chart illustrates, wage inflation remains benign, providing the Fed with a sufficient enough cushion to avoid tightening too quickly and stifling progress.

2.5 False start in Europe...

Not many people expect Europe to grow at the pace of the US; it's been a long time since it has. And while economic growth will accelerate in 2015, the de-coupling witnessed in the second half of 2014 will continue. This divergence also extends into Europe, as the United Kingdom continues to out-perform its nearneighbours. The eurozone economy will not only fail to keep pace with the US and UK, but monetary policy will diverge as the Fed and Bank of England raise administered rates while the ECB holds the line in an attempt to stimulate growth and stave off deflation.

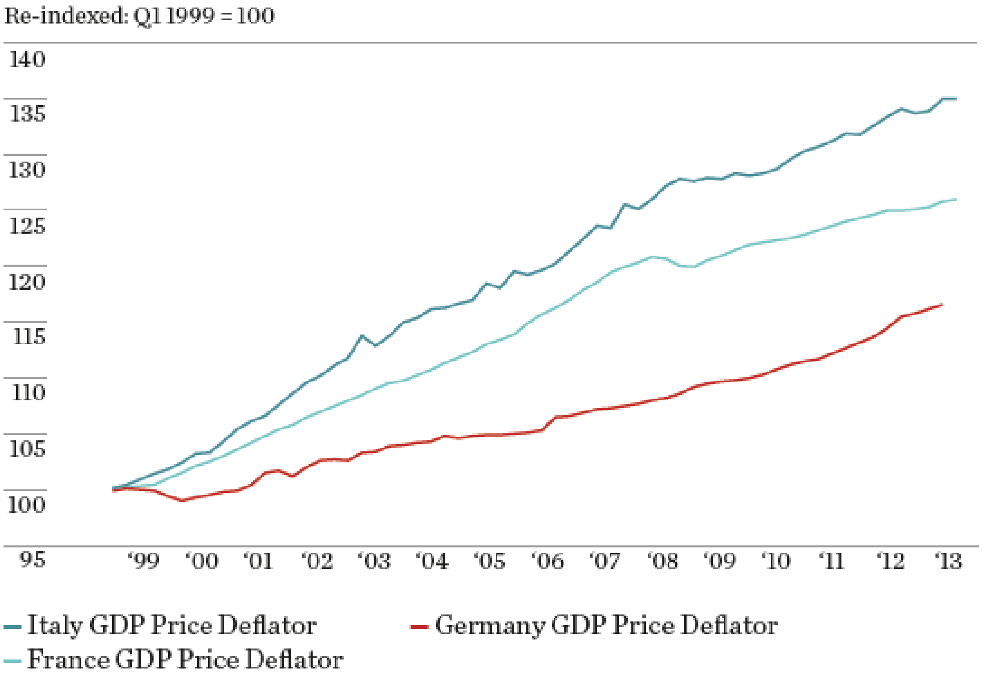
ECB President Mario Draghi can be credited with talking markets back from the brink in 2012 when he committed to doing 'whatever it takes' to protect the euro. He can certainly bring the full resources of the ECB to bear if the potential break-up reflects stresses caused by long-term interest rate divergence within the region, but there are structural issues that cannot be resolved in this way.

2.6 Different speeds

One such issue is that of competitiveness within the euro area, which is amply illustrated in the output price chart. This shows the evolution of output prices in the region's three biggest economies and the clear advantage that German industry has over its neighbours.

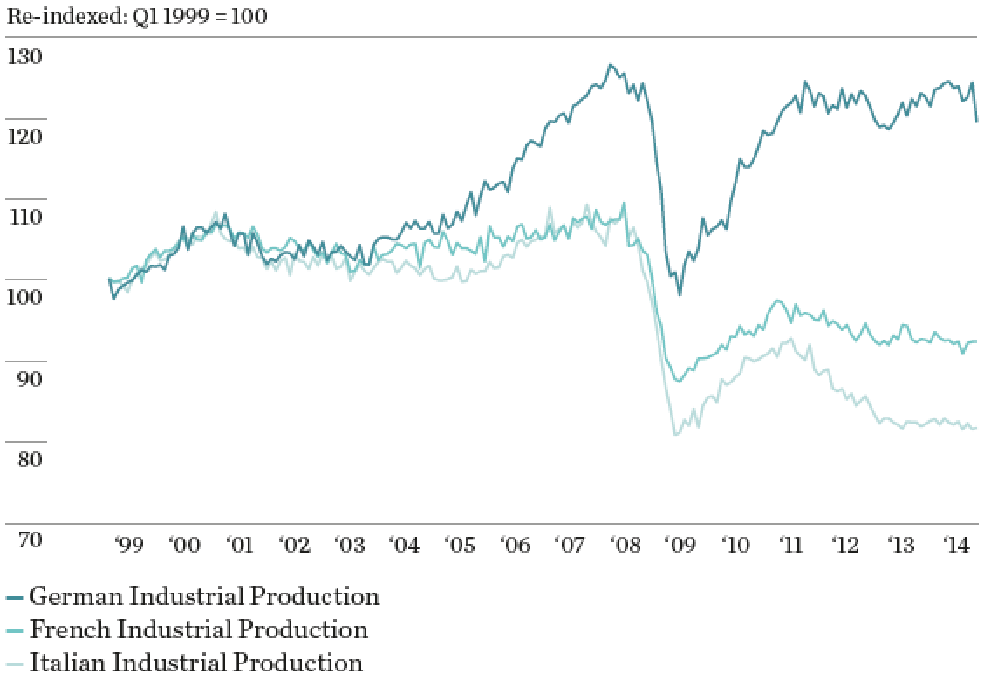
The red line shows that the prices of goods and services produced in Germany have risen by about 15% since the inception of the eurozone in January 1999, while the green and blue lines show that prices have risen by about 25% and 35% in France and Italy, respectively.

Figure 7: Divergence within the Eurozone



Sources: Eurostat. As of 28 November 2014.

Figure 8: German dominance persisting



Sources: Bundesbank, National Institute of Statistics and Economic Studies, National Institute for Statistics. As of 28 November 2014.

This marked divergence of competitiveness has led to a marked divergence of economic performance, as revealed by the paths of industrial production in the above chart. German industrial production has risen by approximately 20% since the inception of the eurozone, while French and Italian production have fallen by around 10% and 20%, respectively.

A solution to this problem involves squeezing the price lines together, i.e. restoring relative competitiveness. Normally, the burden of such an adjustment would be thrown on the exchange rate.

The deutschemark would rise, pushing the red line up, while the franc and lira would fall, pushing the green and blue lines down. But, of course, that is impossible given those exchange rates no longer exist. A second way is to raise the price level in Germany (raise inflation for some period of time) and/or lower the price levels in France and Italy by creating deflation, via high unemployment. That is the underlying rationale for the austerity programs. But, as the graph here shows, there has not been much progress, so the problem persists, with no obvious mechanism for fixing it (or at least fixing it quickly) in sight.

2.7 Out of sync

This competitive divergence hampers synchronicity – member economies growing simultaneously – and hinders the growth of the overall region. Hence, growth will accelerate only slightly next year, leaving it not much above 1.0%. This improvement Notwithstanding, there are some serious issues that need addressing. The labour market is weak, inflation is edging towards deflation territory and private sector credit is still shrinking.

In short: a modest cyclical recovery is occurring against the backdrop of structural flaws that Mario Draghi cannot rectify. Moreover, weak and uncompetitive countries are having to internally devalue via austerity, while the more competitive countries are not adjusting.

A strong case can be made for stimulating German domestic demand. This would raise German prices, helping to act as a engine for wider regional growth. But Germany seems determined to avoid much of any stimulus, opting instead to maintain a pattern of fiscal surpluses, thereby increasing the risk that the eurozone might morph into Japan, an economy beset by low growth and deflation for more than two decades.

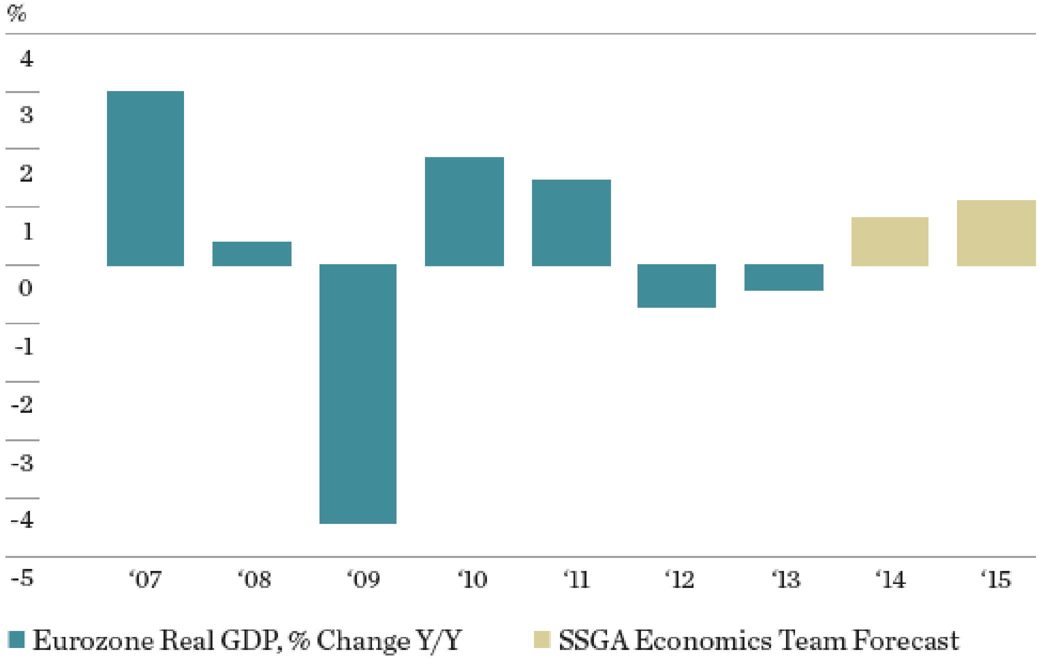
2.8 Abenomics at work in Japan

In Japan, inflation finally reared its head in 2013 and 2014. But that reflected a combination of one-off factors, the sharp depreciation of the exchange rate following the adoption of Abenomics in early 2013 and the three percentage points increase in the consumption tax on 1 April 2014.

The latter was also followed by a sharp slump in economic activity in Q2 and Q3, leading Japan into its fourth recession since 2008. The unexpected contraction triggered Prime

Minister Abe's decision to call a snap December election to delay the second sales tax increase and restore the mandate for Abenomics. We expect growth for 2014 to now come in at just 0.7%,

Figure 9: Growth Continues to Languish Around 1%



Sources: Oxford Economics, SSGA Economics Team. As of 28 November 2014. The above forecasts are estimates based on certain assumptions and analysis made by SSGA Economics Team. There is no guarantee that the estimates will be achieved.

However, we believe that the economy will ultimately prove resilient enough to absorb the effects of the hike, although growth in 2015 may not improve much. Prime Minister Abe has doggedly maintained his pursuit of stronger long-term growth and an end to deflation. The fiscal and monetary stimuli applied thus far have bolstered growth, partially via yen weakness, but a sustained improvement remains dependent on structural reforms. Moreover, to keep inflation on track will require higher wages, something corporate Japan cannot be counted on to deliver.

2.9 Emerging economies

Investors in emerging market assets had something of a bumpy ride through 2014, and while at a headline level the outlook is more positive for the year ahead, the risks to economic activity are generally to the downside. Output growth is expected to accelerate from 4.1% in 2014 to 4.7% in 2015, but prospects vary significantly by region and are inextricably tied up with developments in the advanced economies, particularly in the eurozone.

> **Among the principal risks that could negatively impact emerging economies in 2015 are:**
>
> 1. An unanticipated slowdown in China, with negative effects on Asia and commodity producers.
>
> 2. A 1994/1995 style sell-off in the US Treasury market, which could potentially lead to capital flight from emerging markets with weak policy frameworks and potential contagion.
>
> 3. Negative spillovers from a potential deterioration in any of a number of geopolitical risks.

These are important to more than just emerging market investors as emerging economies currently represent roughly 50% of the world economy, on a purchasing power parity basis, and their share of global output continues to grow. In 2014, growth was nearly 2.5 times faster than that of developed markets. China, the world's second largest economy, now represents roughly 12% of global output in nominal terms, and is larger than the three other BRICs combined.

2.10 The Chinese economy in 2015

The Chinese economy is expected to grow by about 7% in 2015, a level that Chinese officials have indicated is acceptable as a medium-term growth rate. Since announcing the multiple initiatives of the Third Party Plenum (which, among other measures, allocated market-based activities a 'decisive' role in the economy), China's leadership has advanced many policy measures designed to make the economy more flexible and to promote consumption. These may reduce growth in the short term but should lead to a more sustainable pattern of output in the medium term.

Analyst concerns that the Chinese economy is vulnerable to a hard landing should difficulties in the 'shadow banking system', local government debt, or property sector materialise were somewhat assuaged by recent measures to address fiscal issues, local finances and land reform.

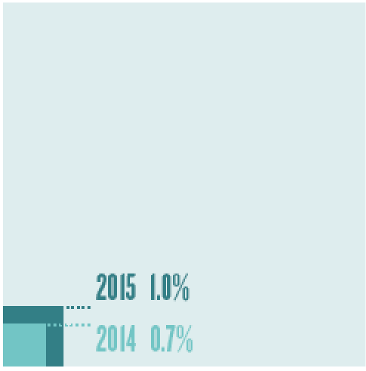
Recent data coming out of China demonstrates continued expansion in the manufacturing sector, but high variability among sectors. For example, China's export growth remains robust, and China's foreign exchange reserves continue to grow, now standing at roughly $3.9 trillion.

2.11 Kinks in the line

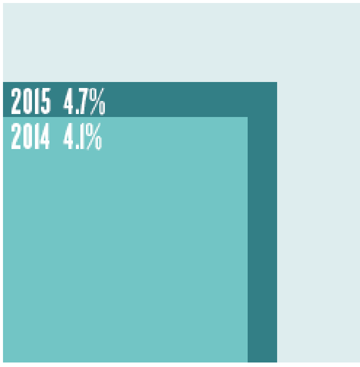
But worries persist. Overcapacity exists in several basic industries and property prices in a growing number of cities have been falling. Against this backdrop, producer price inflation turned more negative in August and September. The government indicated in October that it does not plan to introduce substantial policy stimulus in the near term, although there has been a series of measures to modestly loosen monetary policy since June 2014. Furthermore, if domestic demand were to drop significantly in 2015, we think it likely that additional stimulus measures – both monetary and fiscal – would be forthcoming. Indeed, in November, the People's Bank of China surprised the market by easing policy.

In 2015, Chinese policymakers will focus on implementing the initiatives of the Third Party Plenum and Fourth Party Plenum which, in October 2014, announced additional measures to fight corruption, strengthen law and order, reform the tax system, and reduce pollution, among others. The ongoing anti-corruption campaign and institutionalisation of powers accumulated by President Xi over the past 15 months will be important initiatives in 2015.

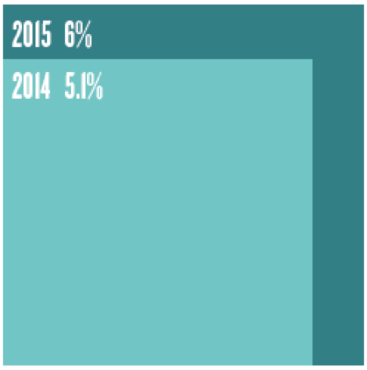
Growth Predictions for Japan



Growth Predictions for Emerging Markets



Growth Predictions for India



Source: SSGA. As of 28 November 2014. The above predictions are estimates based on certain assumptions and analysis made by SSGA. There is no guarantee that the estimates will be achieved.

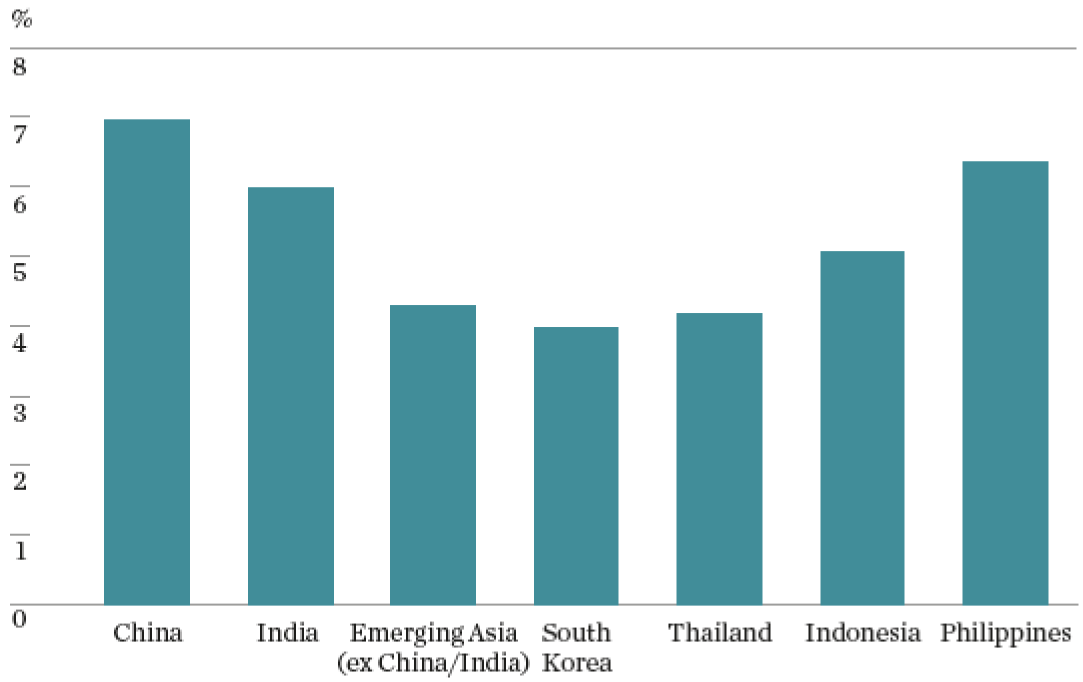
2.12 Beyond China – Emerging Asia

The political dynamic in India changed significantly in 2014 when Prime Minister Modi gained an absolute majority in parliament, something that should facilitate measures to promote foreign direct investment and to render the economy more competitive. Considered more market-friendly for his reform-oriented campaign platform, Modi is likely to oversee an economy growing from 5.1% in 2014 to 6% in 2015, while inflation should fall to 6%.

Growth in Emerging Asia outside China and India is still expected to quicken in 2015. A pick-up in US economic activity should benefit the region's technology sector in particular, which account for about a fifth of Association of Southeast Asian Nations (ASEAN) exports.

Lower oil prices will also provide a tailwind for firms and consumers although commodity exports, which account for roughly 17% of ASEAN GDP, are expected to remain flat in dollar terms given recent price weakness. Improving domestic demand is expected to drive faster growth in South Korea, Indonesia, Philippines, and Thailand.

Figure 10: Emerging Asia GDP continues to grow briskly in 2015



Source: JP Morgan. As of 28 November 2014.

2.13 Latin America – picking up

Brazil had an eventful year in 2014, with street protests in the build-up to, and during, its hosting of the World Cup highlighting issues the world's seventh largest economy has yet to effectively tackle. The economy should emerge from near-recession conditions in 2014, and while high real interest rates will restrain growth, consensus expectations are for the economy to grow by 0.6% in 2015. Disappointingly, this is still less than half of Brazil's potential growth rate.

The removal of electoral uncertainty should help to clarify the policy environment for investors in the real economy, but inflation continues to be a concern. It is thus difficult to envisage the central bank cutting its administered rate of 11.25% in 2015, and the domestic policy environment, as well as commodity price conditions, is likely to restrain growth.

That challenging commodity price environment will also have some impact on Mexico. But with oil now accounting for just 13% of Mexico's total exports, the negative effect of oil price declines is likely to be more than offset by the stepping up of economic activity in the US (as seen in vehicle sales) and continuing liberalisation of the economy. The Mexican economy is expected to grow 3.2% in 2015, up from 2.3% in 2014. Activity is also expected to accelerate in Peru and Colombia.

2.14 Emerging Europe/Middle East/ Africa

South Africa and Turkey will likely lead the way in Emerging EMEA, but there will likely be a divergence of economic performance through the region amid several uncertainties.

Weak oil prices and the impact of sanctions raise a question mark over projected Russian growth of -0.8% in 2015. A flight of capital and rumours of capital controls added to a general sense of uncertainty in 2014. The Russian policy response has been to let the exchange rate depreciate and to support firms with official finance. Inflation is running around 7.5% and the consensus is that credit conditions will remain tight.

Turkey has enjoyed brisk growth in recent years, and while that is expected to accelerate to 3.3% in 2015, inflationary pressures limit the scope for interest rate cuts. Alongside the troubles in nearby Syria, the potential for escalating conflict with internal Kurdish opposition cannot be discounted. Furthermore, Turkey, along with emerging markets in Central and Eastern Europe, would be hurt in the event of a significant downturn in Europe.

2.15 US interest rates and EM

Emerging market policymakers have had time to prepare for what is likely to be a gradual pace of US interest rate increases. Investor reaction to the initial taper comments back in 2013 illustrated how sensitive emerging markets are to tighter US monetary policy. Asian economies in particular benefit from a high level of reserves; some are likely to modestly tighten policy in 2015 as output gaps narrow and US policy firms. The impact on Asian firms and consumers (both of which have borrowed heavily in recent years) should be modest, although the situation merits close monitoring. The currencies of the 'fragile five' (Brazil, India, Indonesia, South Africa, and Turkey) that exhibit both current account and fiscal deficits will likely further depreciate in 2015, thereby exacerbating inflationary pressures. They have strengthened their policy frameworks, and a violent unwind of foreign capital flows is unlikely, albeit something that cannot be completely discounted.

Figure 11: Emerging ex Asia growth forecasts

	Brazil	Mexico	South Africa	Turkey	Russia
2014	0.2%	2.3%	1.3%	3.0%	0.6%
2015	0.6%	3.2%	2.3%	3.3%	-0.8%

Source: JP Morgan. As of 28 N 2104. The above forecasts are estimates based on certain assumptions and analysis made by JP Morgan. There is no guarantee that the estimates will be achieved.

The Oil Change

Brent crude oil prices trended in a narrow band around $110 a barrel in the first half of 2014, before a 37% slide took the price to just $70 at the end of November. Supply is now destined to play a larger role in the evolution of prices over the longer term, but the scale of price decline in such a short time almost certainly involves some reduction in demand.

It now appears that demand in early 2014 was artificially boosted by worries about Libyan output, the potential for ISIS to over-run the southern Iraqi oil fields and how Russia would respond to sanctions. But Libyan output actually rose, ISIS never made it to Baghdad, and Russia kept pumping, a combination that both removed the 'extra' demand and created additional supply. Evidence of slowing growth from Europe, Japan and China has further weighed on oil prices, and a downbeat outlook was validated when the IMF revised down its global growth projections and OPEC decided in November not to cut production.

The futures market suggests that prices will remain near the current $70 a barrel level through 2015, which imparts upside risk to our growth projections. Growth in 2015 would rise by 0.4% in the advanced economies, 0.3% in the developing ones, and 0.3% for the world as a whole. Growth would rise by 0.5% in the US, 0.3% in the Eurozone and 0.1% in Japan, while among the developing economies, there are clear winners and losers; growth increasing 0.8% in China but falling 4.1% in Russia.

Oil at $70 also exerts downward pressure on headline inflation; the energy component accounts for 9% of US CPI. This would have a moderating effect on the US inflation rate, while potentially pushing headline Eurozone inflation below zero. This downward adjustment in inflation expectations has resulted in lower global bond yields and pushed out market expectations for when US policy tightening might start.

2.16 Geopolitical Risks in 2015

Few of the geopolitical flashpoints that erupted in 2014 will simply dissipate with the turn of the calendar. History shows that equity markets can be resilient to geopolitical shocks, certainly in comparison with major global economic downdrafts, but the short-term impact can be substantial. Potential risks lie in a widening conflict in the Ukraine and/or the Middle East, a global ebola pandemic, a mis-handling of the situation in Hong Kong (which could hit foreign direct investment into China), a breakdown of the Iran nuclear talks, or a flare-up of the eurozone crisis.

Oil price declines are generally a plus for economic activity, with net importers from Europe to Japan to Emerging Asia benefiting; Russia and the Gulf Cooperation Countries (GCC) countries lose out in this scenario. On the other hand, a severe disruption to deliveries from the Persian Gulf would weigh more heavily on emerging markets.

2.17 The outlook

That the global economy didn't kick on in 2014 may instil some scepticism among investors about 2015's prospects. However, we are confident that the pick-up will materialise, although the diverging fortunes of the US and Europe could threaten the most upbeat forecasts. In a likely scenario that sees the US de-coupling from much of the rest of the developed world, global economic growth will thus be largely reliant on outcomes in the US and China. The wobble on financial markets in October came at a time of both geopolitical and economic anxiety; sentiment can change rapidly.

In its recent World Economic Outlook, the IMF reduced the medium-term growth forecast for emerging markets by 1.5% relative to pre-crisis years. China's rebalancing, slower world trade growth, increased financial frictions, slower productivity growth, and demographics all contribute to this assessment. In 2015, accelerating growth in the US and stable growth in China (together roughly 35% of the global economy) should facilitate an expansion of economic activity for both developed and emerging markets, provided geopolitical conditions do not deteriorate markedly.

2. DIVERGENCE AND INVESTMENT OPPORTUNITIES

We are upbeat about prospects for 2015. However, in a year when economic fortunes and central bank policies will diverge, it will be important to be positioned in a way that recognises the challenges and identifies where the potential opportunities lie. However, this is rarely as intuitive as one might think – cheap does not always imply value and expensive may not mean overpriced. We believe one of the keys to successful investing is finding a path that effectively balances risk and return objectives. We have identified what we believe will be important themes to consider through 2015, and we lay out a roadmap to help with navigation through the changing landscape. Adopting the appropriate strategies can make that journey all the smoother.

2.1 Getting the big one right - Equity market risk

Long periods of low volatility may have left investors complacent but with equity indices at all-time highs and bond yields at all-time lows, risk aversion has spiked sharply upwards. Savvy investors need to get the balance right and implement risk protection that can let them access upside in 2015 while protecting against coming volatility.

2.2 Shifting gears in a two-speed market - Equity valuation differentials

Improving economic and earnings environments bring opportunities, even in expensive markets. The US is fully valued but continued strong growth in 2015 may see it maintain that value, even as diverging interest rates reshape the investment landscape. European market valuations indicate good upside potential if an earnings recovery materialises.

2.3 What emerging market reform can deliver - Emerging markets

We've observed that investors sifting developing markets for opportunities are favouring those countries where reforms are on the agenda. Recognising where the reformers are and how reforms boost competitiveness and improve earnings potential can help pinpoint prospects for the considered investor.

2.4 It's all relative - Fixed income & currency

Sovereign rate differentials between those regions with loosening central bank monetary policy and those that are in tightening mode are likely to continue to provide some of the biggest opportunities for fixed-income investors in 2015. More than this, diverging global monetary policy and interest rates will impact almost every asset class in 2015.

2.5 The macros is not the market - European financial landscape

Europe's structural problems are legion and well known. But tailwinds are also rising. The ECB is in play and measures such as the Asset-Backed Security Purchase program are moving the dial. We believe Europe has pockets of value, the challenge, as ever, is finding them. Investors will have to tease apart the macro from the market and operate selectively.

Read "Global growth divergence in 2015" in full

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