Cologne, January 18, 2012

Flash Update

Equity short-term models: Factor Monitor

Generali Investments Research

Our equity short-term models are designed to give a quantitative indication on the direction of the most likely market movements over the next three months. Since we intend to base our forecasts on as much information as available, we proceed to combine forecasts from different models representing different methodological approaches. The expected / fair value is thus aggregated from individual forecasts, with the weights reflecting the forecasting success over the last five years (average time span of a business cycle) of each model incorporated. The current update of these models revealed the following findings:

- All covered indices show an upside potential
- With an upside potential of around 1.7% for the S&P500, the US market represents the least attractive market from current expectations point of view.
- Compared to three months ago, the TOPIX has experienced a decrease of 6.3% in its fair value, which makes the Japanese market the least attractive from a momentum point of view.
- With a fair-value gap of 13.2% for the China and roughly 12.9% for the MSCI EMU, the Chinese and the European equity markets are the most attractive ones.
- Apart from the FTSE 100 and the TOPIX, all estimated fair-values, judged from the upside potentials, are higher than three months ago.

Euro Area (MSCI EMU):

The decrease in earnings' dispersion coupled with the fall of bond yields and exchange rates had a positive contribution and have outweighed the negative influence of the decrease in the business climate and in earnings, which brought about the increase in the fair value (total contribution of 68% vs. 32%).

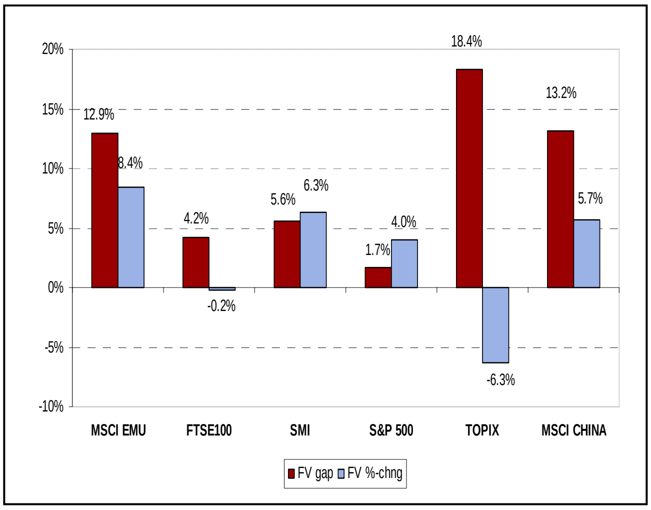
US (S&P 500):

The increase in the long-term earnings and the fall in bond yields, the dispersion of earnings, and the growth in commodity prices had a positive contribution to the change in the fair value and outweighed the negative effect of the decrease in earnings (total contribution of 64% vs. 36%).

Switzerland (SMI)

Only the decrease in long-term earnings growth had a negative influence on the change of the fair value and was significantly outweighed by the beneficial decrease in exchange rates, the dispersion of earnings and bond yields as well as the increase in earnings (total contribution of positive factors is 82%).

Current fair-value gap and fair-value change compared to 3 months ago for the chosen equity markets



UK (FTSE 100):

The slight decrease in the fair value is due to the fall of industrial production coupled with the decrease in the business sentiment / consumer confidence and earnings, which outweighed the positive effect of the fall in the bond yields (total contribution of negative factors is 53% vs. 47% for positive factors).

Japan (TOPIX):

The decrease in the fair value was brought about by the fall in earnings and long-term-earnings and the decrease in the composite leading indicator and the price-to-book factor, which have outweighed the positive effect of the decrease in the bond yields and the unemployment (total contribution of negative factors is 64% vs. 36% for positive factors).

China (MSCI China):

The increase in the fair value resulted from the decrease in the commodity prices, which outweighed the negative effect of the decrease in earnings and inflation and the increase in earnings' dispersion (total contribution of negative factors being equal to ca. 41%).

On this page we show the main factors responsible for the change in the fair value compared to 3 months ago. Common to all equity markets is a decrease in bond yields. Major markets (EMU, US) have experienced the fall in earnings coupled with the decrease in the dispersion of earnings. The Chinese market is the only one, which has a high uncertainty for earnings, as is manifest in the increase in its earnings' dispersion.

Euro Area:

Earnings and the business climate had a negative contribution and were outweighed by the positive influence of the beneficial decrease in exchange rates, the decrease in the earnings' dispersion and in the bond yields (total contribution of 68% vs. 32%). The earnings' factor might well be the main risk over the short-term due to expectations of falling earnings.

Euro Area

Factor	% chng	% contribution
Earnings	-6.1%	-30.1%
Dispersion Of Earnings	-12.2%	33.4%
Exchange Rate	-3.2%	29.8%
Business Climate Index	-0.3%	-2.0%
10 Year Bond Yield	-9.2%	4.7%

US:

The only factor that had a negative contribution to the fair value is the earnings factor. The rest of the factors had a positive contribution (growth in commodity prices has fallen, as did the bond yields and the earnings' dispersion. The long-term earnings growth has increased ultimately caused the increase in the fair value compared to 3 months ago (total contribution of positive factors is 64% vs. 36%). As earnings fall, the long-term earnings growth may decelerate, thus presenting a major risk for the US market.

US Market

Factor	% chng	% contribution
Growth in commod. prices	-43.0%	19.6%
10 Year Bond Yield	-8.9%	15.6%
Long-term Earnings Growth	2.4%	10.1%
Dispersion Of Earnings	-10.8%	18.9%
Earnings	-1.5%	-35.8%

Switzerland:

The fair value for the Swiss equity market has increased, which resulted from the decrease in exchange rates and a fall of bond yields as well as the increase in earnings and the decrease in the dispersion of earnings. The only negative factor is the long-term earnings growth but it has a total contribution of only 18% (total contribution of positive factors is 82%). It should again be noted that earnings have experienced some sort of turnaround compared to the situation 3 months ago. The 3M earnings surprise turned from negative to positive and the dispersion of earnings has significantly decreased, after being on the rise. However, the long-term earnings growth stayed at the approximately same negative level.

Swiss Market

Factor	% chng	% contribution
10 Year Bond Yield	-29.1%	32.5%
Exchange Rate	-3.2%	25.3%
Dispersion Of Earnings	-8.3%	20.5%
Long-term Earnings Growth	-8.5%	-17.7%
Earnings	0.3%	4.0%

Japan:

The decrease in unemployment had a positive effect on the change in the fair value compared to the value 3 months ago and slightly outweighed the negative contribution of the decrease in earnings and long-term earnings as well as in the composite leading indicator.

In the alternative model, the fair value has decreased. While the fall in bond yields coupled with the decrease in the earnings' dispersion had a positive contribution to the fair value, it was outweighed by the decrease in the price-to-book factor (total contribution of 92% vs. 8%).

Factor	% chng	% contribution
Unemployment Rate	-10.9%	58.3%
Composite Leading Indicator	-1.2%	-17.7%
Long-term Earnings Growth	-34.3%	-12.8%
Earnings	-3.0%	11.2%

Factor	% chng	% contribution
Price-to-Book Ratio	-12.0%	-91.8%
10 Year Bond Yield	-10.0%	5.2%
Dispersion Of Earnings	-8.2%	3.0%

Overall, the fair value has experienced the decrease since 3 months ago, which does not bode well from the momentum point of view. Besides, compared to the situation 3 months ago, earnings growth underwent a turnaround, changing signs from positive into negative.

UK:

The fall in the fair value was due to the decrease in industrial production, earnings, business sentiment and the increase in unemployment, which have outweighed the positive contribution of the decrease in bond yields (total contribution of negative factors is 62% vs. 38% for negative factors).

In the alternative lagging model, the fair value has somewhat increased. It is only the decrease in bond yields that had a positive contribution to the fair value and outweighed the negative effect of the decrease in consumer confidence and the slight decrease in FY1 and FY2 earnings (total contribution of 77% vs. 23%).

UK Market

Factor	% chng	% contribution
10 Year Bond Yield	-18.4%	38.4%
Industrial Production	-0.8%	-27.5%
Unemployment Rate	5.1%	-23.8%
Earnings	-4.0%	-6.7%
Business Sentiment	-1.2%	-3.6%

Factor	% chng	% contribution
10 Year Bond Yield	-17.4%	76.7%
Consumer Confidence Indicator	-18.7%	-9.2%
Earnings for Year FY2	-3.6%	-9.8%
Earnings for year FY1	-0.6%	-4.3%

China:

The rise in the fair value resulted from the increase in the commodity prices, which have outweighed the negative influence of the increase in earnings' dispersion and the decrease in earnings and inflation (total contribution of negative factors being 41%).

China

Factor	% chng	% contribution
Earnings dispersion	9.5%	-30.9%
Earnings	-2.9%	-8.6%
Commodity Prices	-7.3%	59.3%
Inflation	-32.8%	-1.2%

Conclusion

Judging from the short-term models, which are based on the last available financial data, macroeconomic variables and current market expectations, the Chinese and the European markets seem to be the most attractive. The Japanese market has a high upside as well, but is not so attractive from a momentum point of view. Also, its earnings growth has just experienced a turnaround, which may put an additional pressure on equities.

Judging by current expectations point of view, the US market is the least attractive. It is still the only market with a positive long-term earnings growth, which is, given the current macro environment, uncertain.

Appendix

This page contains the summary table of factors found significant in equity markets' modeling.

The models set up for the stock markets

1. are checked for the factors' economic consistency and importance and statistical significance
2. provide high goodness of fit and forecasting power
3. are maintainable at a reasonable cost

Factors	Equity Market					
	MSCI EMU	FTSE100	S&P 500	SMI	TOPIX	MSCI China
Earnings	✓	✓	✓	✓		✓
Dispersion Of Earnings	✓		✓	✓	✓	✓
Long-term Earnings Growth	✓		✓	✓	✓	
10 Year Bond Yield	✓	✓	✓	✓	✓	
Exchange Rate	✓	✓		✓		
Unemployment Rate / jobless claims			✓		✓	
Composite Leading Indicator					✓	
Industrial Production	✓	✓	✓		✓	
Price-to-Book Ratio	✓		✓		✓	
Business Climate Index / Sentiment	✓	✓				
Consumer Confidence Indicator		✓				
Inflation						✓
Commodity prices			✓			✓

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