

## Global Market Strategy Research

# Regional and Sector Strategy: Monthly Update

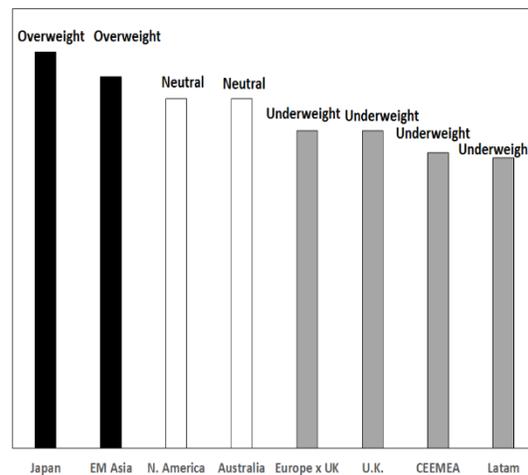


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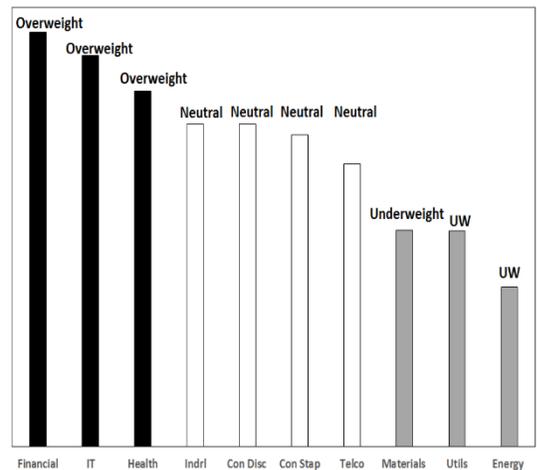
- **Regional Strategy** — Our regional strategy is unchanged. We continue to have a defensive tilt in our regional recommendations, and are Underweight the commodity-rich regions of CEEMEA and Latin America.
- **Highlighting a Country** — Japan continues to be the top-ranked country. Over the past twelve months, share buybacks in Japan have been the largest of any country / region, the first time that country has been the global buyback leader since we launched the regional model in April 2014.
- **Sector Strategy** — Our sector strategy is also unchanged and remains “less cyclical, more defensive.”
- **Highlighting a Sector** — The Energy sector has gotten more expensive for the second month in a row suggesting, perhaps, that stock prices in the sector have not fallen as fast as earnings estimates.

**Figure 1: Regional Rankings**  
Arrows Indicate Change vs. Last Month



Source: Cornerstone Capital Inc.

**Figure 2: Sector Rankings**  
Arrows Indicate Change vs. Last Month



Source: Cornerstone Capital Inc.

## Regional and Sector Strategy: Monthly Update

This month there are no changes to the recommendations in our regional and sector strategy models. Our previous regional and sector recommendations were published in the February 2015 edition of the Cornerstone Capital [Regional and Sector Strategy: Monthly Update](#).

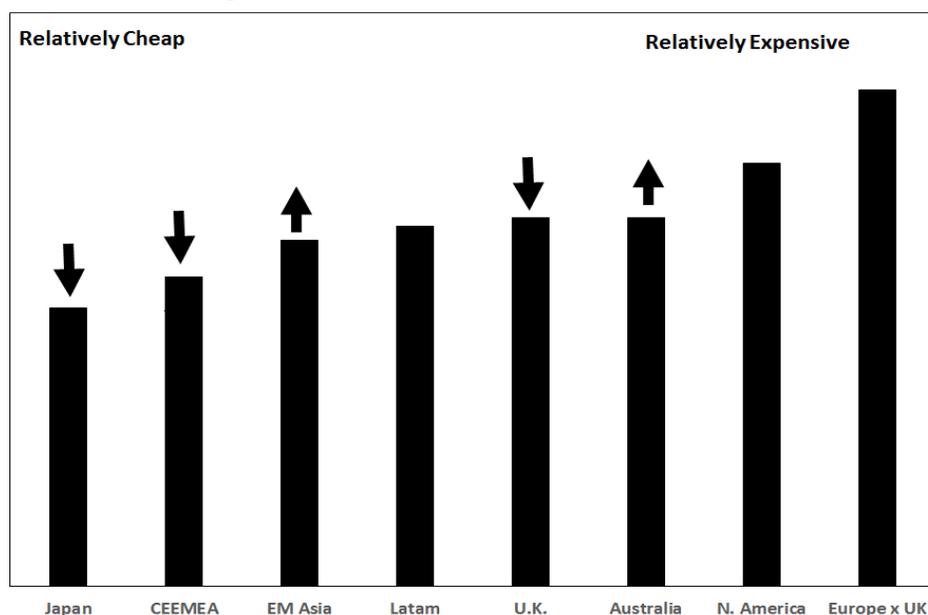
Our regional strategy is unchanged. We continue to have a defensive tilt in our regional recommendations, and are Underweight the commodity-rich regions of Central and Eastern Europe, Middle East and Africa (CEEMEA) and Latin America.

Our sector strategy is also unchanged and remains “less cyclical, more defensive.” We are Overweight Health Care in North America, the U.K. and Europe ex U.K. We are Underweight or Neutral Energy and Materials in the majority of regions.

### Regional Strategy Update

We have updated the inputs to the Cornerstone Capital Regional Strategy Model in which we rank eight regions/major economies that are included in the MSCI All Country World Index (ACWI). In terms of valuations, Figure 3 illustrates that the valuation of Japan, which we are Overweight, has become even more attractive. Our other Overweight — Emerging Asia — continues to look attractive on a relative valuation basis, even though the region has become a little more expensive.

**Figure 3: Regional Valuations (50% of Aggregate Weight)**  
*Arrows Indicate Change vs. Last Month*

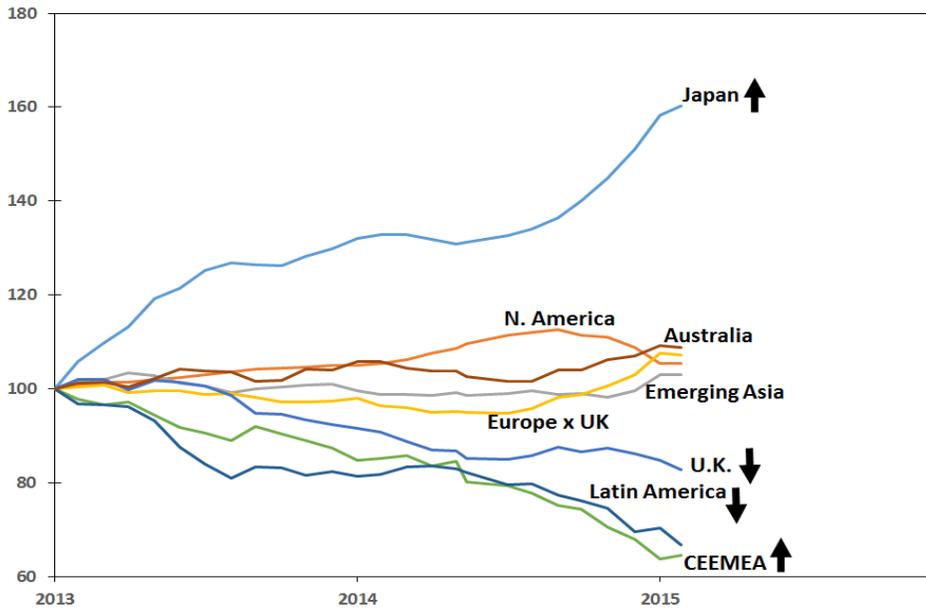


Up = More Expensive  
Down = Less Expensive

Source: Cornerstone Capital Inc.

Figure 4 illustrates that earnings momentum in Japan continues to improve, while earnings momentum in the U.K. (downgraded to Underweight in January) has weakened further.

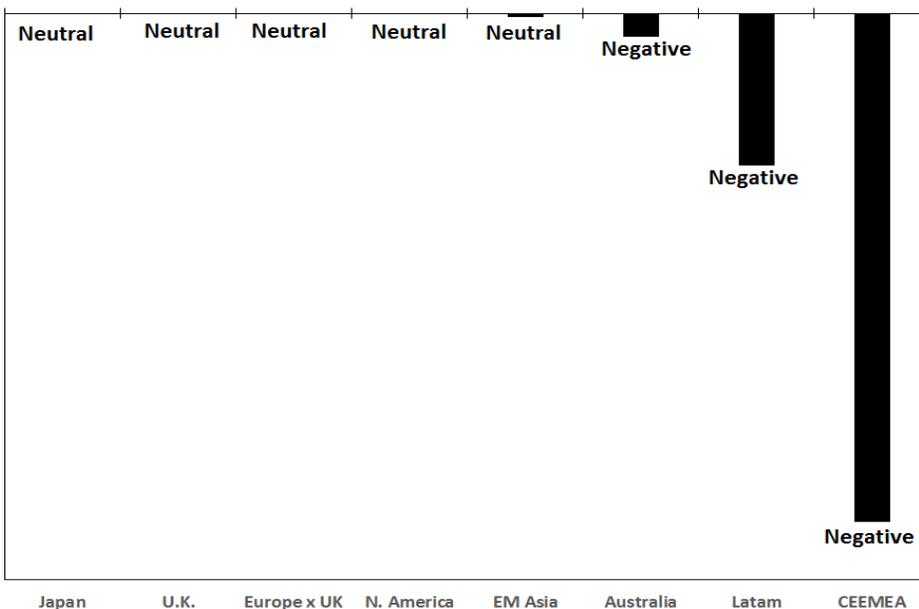
**Figure 4: Earnings Momentum (33% of Earnings Weight)**  
*Arrows Indicate Change vs. Last Month*



Source: Cornerstone Capital Inc.

Figure 5 illustrates that the earnings revisions trends in two of our Underweight regions — CEEMEA and Latin America — remain extremely negative i.e., downgrades by far exceed upgrades.

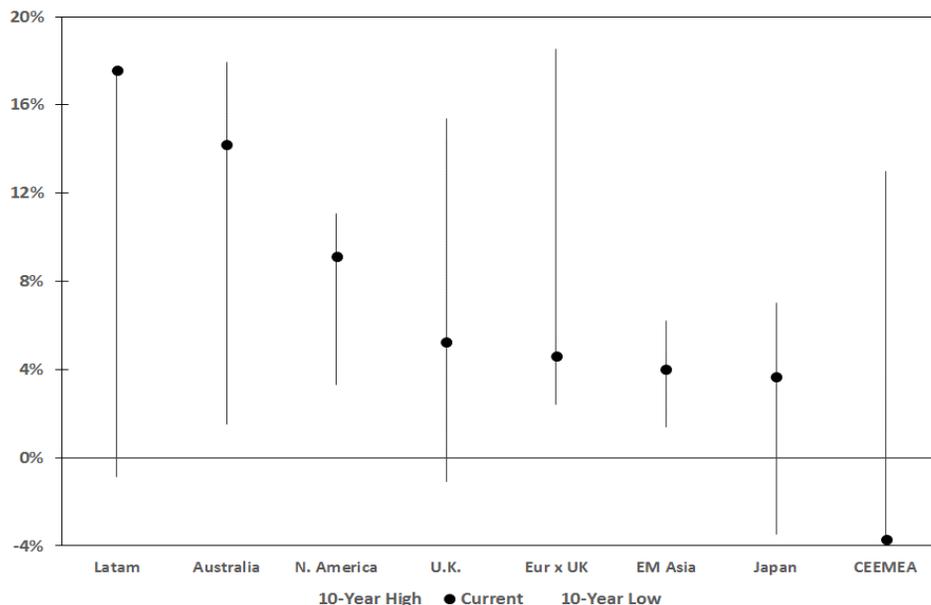
**Figure 5: Earnings Revisions (33% of Earnings Weight)**



Source: Cornerstone Capital Inc.

Figure 6 illustrates that free cash flow margins in the Underweight CEEMEA region are currently at ten-year lows.

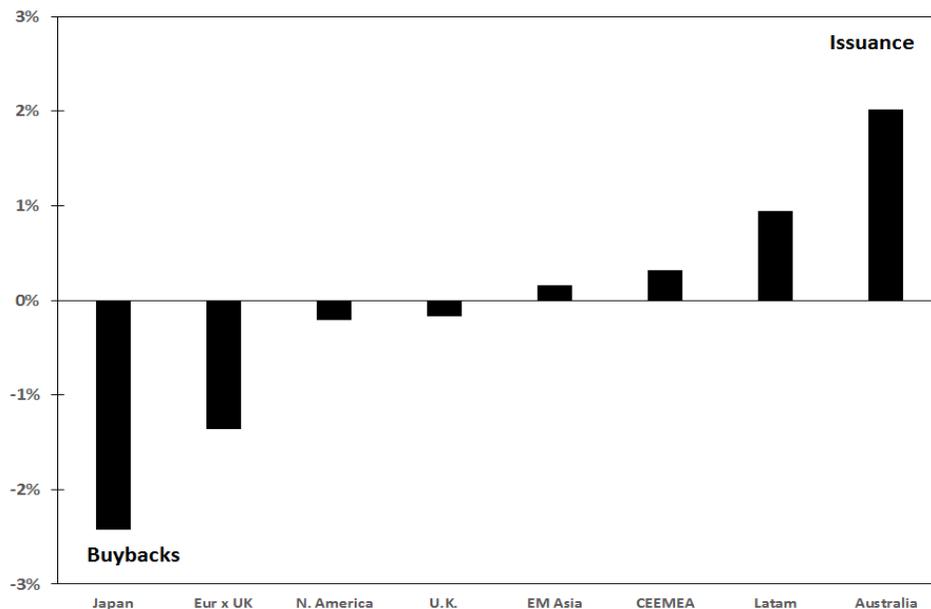
**Figure 6: Free Cash Flow Margins (15-20% of Earnings Weight)**



Source: Cornerstone Capital Inc.

Figure 7 illustrates that, over the past twelve months, share buybacks in Japan have been the largest of any country / region, the first time that country has been the global buyback leader since we launched the regional model in April 2014.

**Figure 7: Net Share Issuance (15-20% of Earnings Weight)**



Source: Cornerstone Capital Inc.

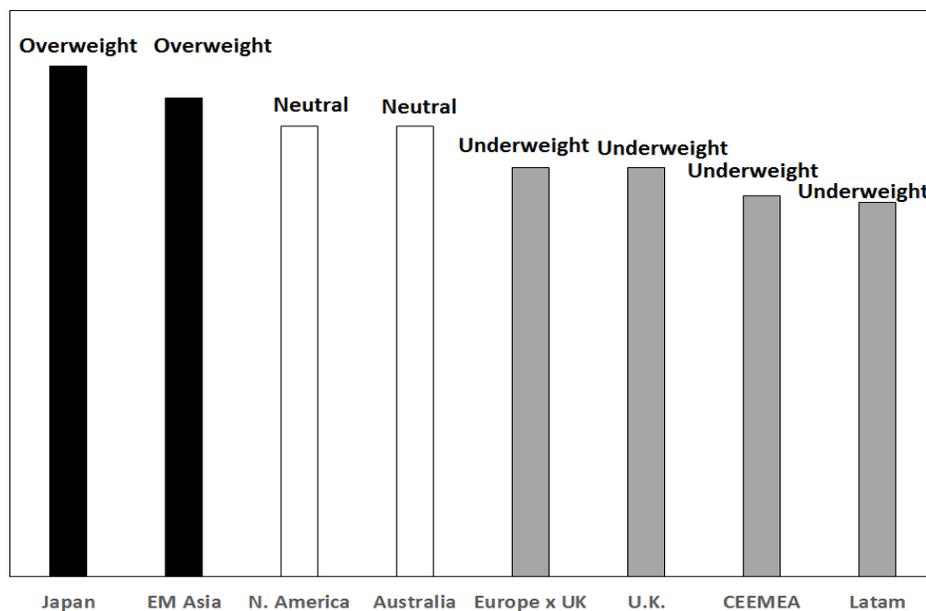
Figure 8 summarizes the current regional recommendations and Figure 9 illustrates the dispersion of the regional scores.

**Figure 8: Regional Recommendations**

Region / Major Economy	Recommendation	Valuation (Relative)	Governance (Relative)	Earnings Momentum	Earnings Revisions	Margins (Relative)	Share Buybacks
Japan	Overweight	Positive	Neutral	Positive	Neutral	Negative	Positive
EM Asia	Overweight	Positive	Negative	Positive	Neutral	Negative	Negative
North America	Neutral	Negative	Positive	Neutral	Neutral	Positive	Positive
Australia	Neutral	Negative	Positive	Neutral	Negative	Positive	Negative
Europe x U.K.	Underweight	Negative	Neutral	Positive	Neutral	Neutral	Positive
U.K.	Underweight	Neutral	Positive	Negative	Neutral	Negative	Positive
CEEMEA	Underweight	Positive	Negative	Negative	Negative	Neutral	Negative
Latin America	Underweight	Neutral	Negative	Negative	Negative	Positive	Negative

Source: Cornerstone Capital Inc.

**Figure 9: Ranking Regions by Weighting Valuation, Earnings and Governance Scores**



Source: Cornerstone Capital Inc.

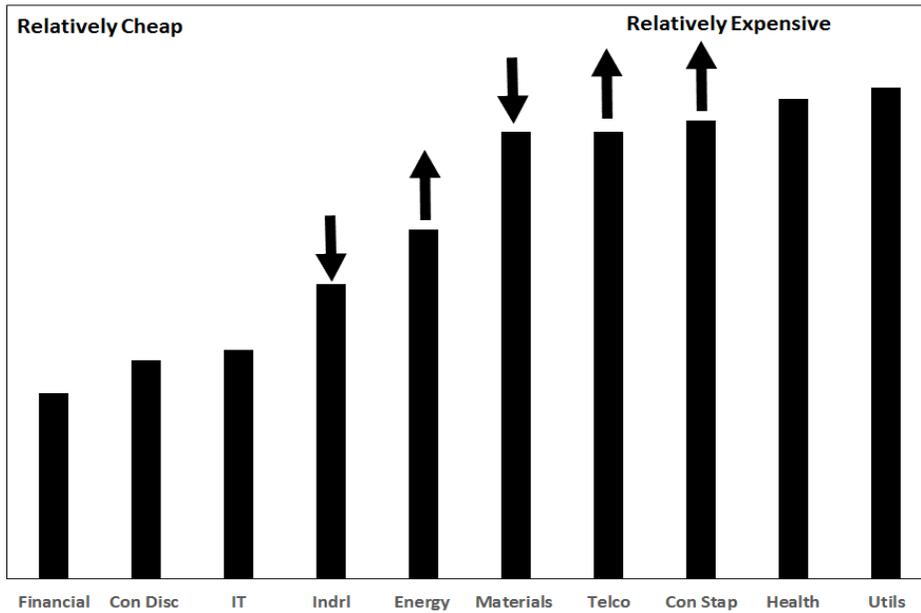
## Sector Strategy Update

We have updated the inputs to the Cornerstone Capital Sector Strategy Model in which we rank the ten GICs in the MSCI ACWI.

Figure 10 illustrates that the Energy sector has gotten *more expensive* on a relative basis for the second month in a row suggesting, perhaps, that stock prices in the sector have not fallen as fast as earnings estimates.

**Figure 10: Sector Valuations (20% of Aggregate Weight)**

*Arrows Indicate Change vs. Last Month*



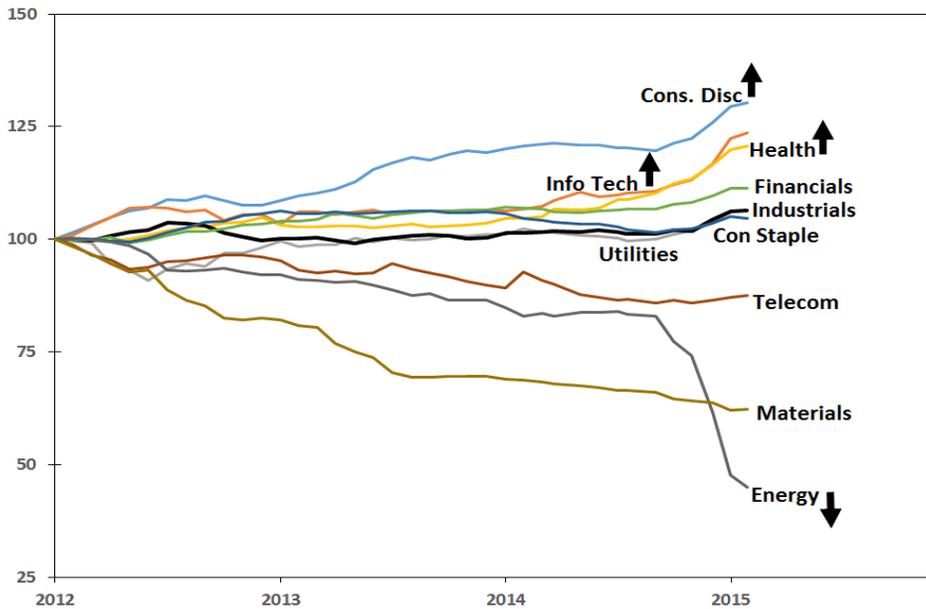
Up = More Expensive  
Down = Less Expensive

Source: Cornerstone Capital Inc.

Figure 11 illustrates that earnings momentum in the Energy sector weakened significantly once again.

**Figure 11: Earnings Momentum (33% of Earnings Weight)**

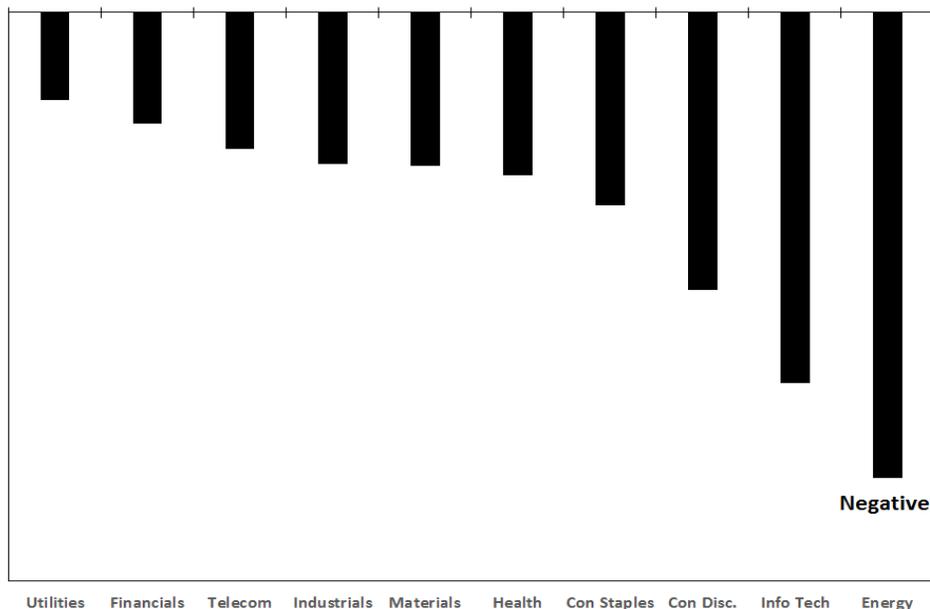
*Arrows Indicate Change vs. Last Month*



Source: Cornerstone Capital Inc.

Figure 12 shows that the Energy sector's earnings estimate revisions continued to be sharply negative i.e., downward revisions by far outpaced (any) upward revisions.

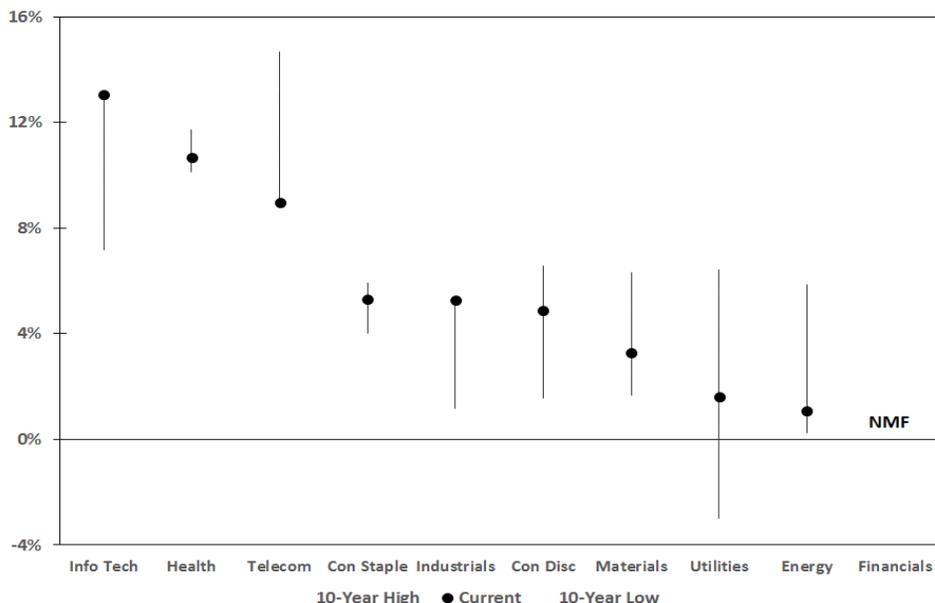
**Figure 12: Earnings Revisions (25% of Earnings Weight)**



Source: Cornerstone Capital Inc.

Figure 13 illustrates that free cash flow margins in the Information Technology and Health Care sectors remain materially higher than most other sectors.

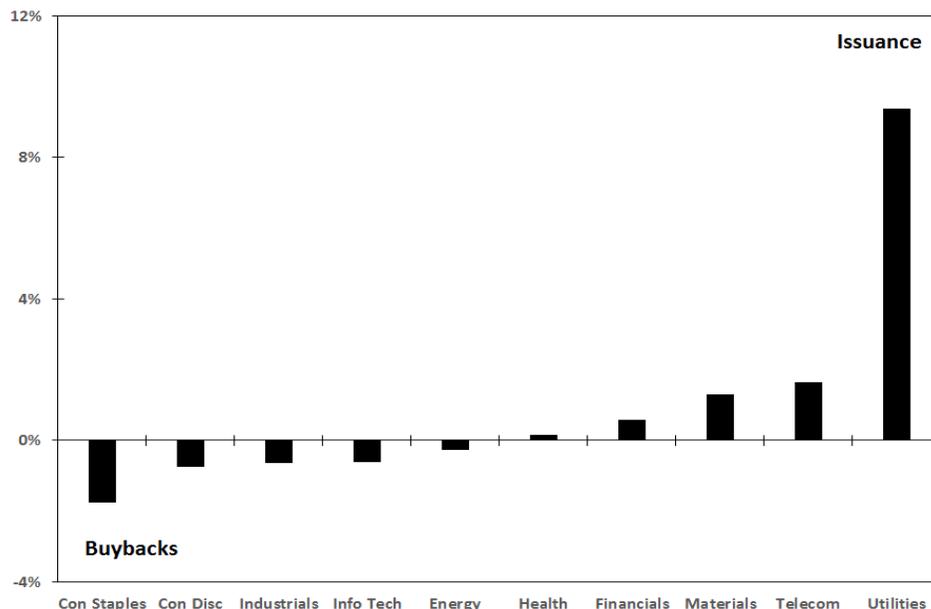
**Figure 13: Free Cash Flow Margins (25% of Earnings Weight)**



Source: Cornerstone Capital Inc.

Figure 14 illustrates that two of our three Underweight sectors — Utilities and Materials — have experienced a significant amount of share issuance over the last twelve months.

**Figure 14: Net Share Issuance = 15-20% of Earnings Weight**



Source: Cornerstone Capital Inc.

Figure 15 summarizes the current sector recommendations.

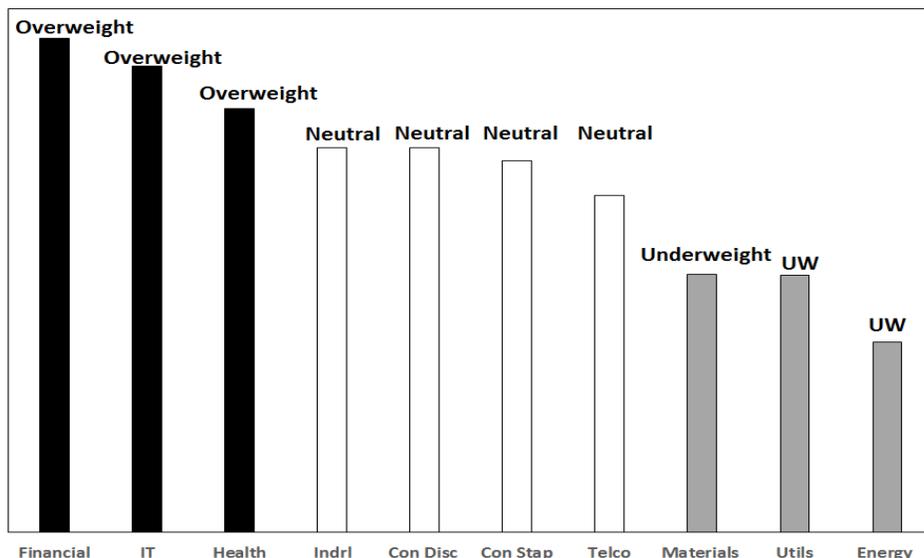
**Figure 15: Sector Recommendations**

Sector	Recommendation	Valuation (Relative)	Earnings Momentum	Earnings Revisions	Margins (Relative)	Share Buybacks	Environmental (Relative)	Social (Relative)
Financials	Overweight	Positive	Positive	Negative	Neutral	Negative	Negative	Neutral
Info Tech	Overweight	Positive	Positive	Negative	Positive	Positive	Neutral	Neutral
Health Care	Overweight	Negative	Positive	Negative	Positive	Neutral	Negative	Negative
Industrials	Neutral	Neutral	Neutral	Negative	Negative	Positive	Positive	Negative
Cons Disc	Neutral	Positive	Neutral	Negative	Neutral	Positive	Positive	Neutral
Cons Staples	Neutral	Negative	Neutral	Negative	Neutral	Positive	Positive	Neutral
Telecom	Neutral	Neutral	Negative	Negative	Positive	Negative	Neutral	Negative
Materials	Underweight	Neutral	Negative	Negative	Neutral	Negative	Neutral	Positive
Utilities	Underweight	Negative	Neutral	Negative	Negative	Negative	Negative	Positive
Energy	Underweight	Neutral	Negative	Negative	Negative	Neutral	Neutral	Positive

Source: Cornerstone Capital Inc.

Figure 16 illustrates the dispersion of the sector scores.

**Figure 16: Ranking Sectors by Weighting Valuation, Earnings and ESG Scores**  
**Arrows Indicate Change vs. Last Month**



Source: Cornerstone Capital Inc.

## Combining the Regional and Sector Models

Combining our regional and sector models, Figure 17 illustrates sector Over- and Under-weights by region.

- We are Overweight *Health Care* in North America, Europe ex U.K. and the U.K.
- We are Underweight or Neutral *Energy* and *Materials* in the majority of regions.

**Figure 17: Combining the Regional and Sector Models**

	Japan	EM Asia	North America	Australia	Europe x U.K.	U.K.	CEEMEA	Latin America
Financials	Underweight	Neutral	Underweight	Overweight	Neutral	Underweight	Overweight	Overweight
Info Tech	Overweight	Overweight	Overweight	NMF	Neutral	NMF	NMF	NMF
Health Care	Neutral	NMF	Overweight	Neutral	Overweight	Overweight	NMF	NMF
Industrials	Overweight	Neutral	Overweight	Underweight	Overweight	Neutral	NMF	Underweight
Cons Disc	Overweight	Neutral	Overweight	Underweight	Neutral	Underweight	Overweight	Underweight
Cons Staples	Underweight	Underweight	Neutral	Neutral	Overweight	Overweight	Underweight	Overweight
Telecom	Neutral	Overweight	Underweight	Underweight	Underweight	Neutral	Overweight	Overweight
Materials	Underweight	Underweight	Underweight	Overweight	Neutral	Underweight	Neutral	Underweight
Utilities	NMF	NMF	Neutral	Neutral	Underweight	Underweight	NMF	Underweight
Energy	NMF	Neutral	Overweight	Underweight	Underweight	Underweight	Underweight	Neutral

Source: Cornerstone Capital Inc.



## Appendix 1: Summary Statistics

Figure 18: Global Equity Markets Data

3/1/2015	Weight in MSCI ACWI	% chg 1 Month (\$)	% chg YTD (\$)	P/E Ratio Trailing	P/E Ratio 20-yr Avg	2015 EPS Growth (e)
MSCI AC World	100%	5.4%	3.7%	17.5	20.1	13%
North America:	55%	5.6%	2.1%	19.1	19.3	14%
----U.S.	51%	5.6%	2.5%	19.2	19.4	13%
----Canada	3%	6.0%	-3.1%	19.0	19.1	18%
Europe x UK:	15%	6.0%	6.5%	22.0	17.3	12%
----France	3%	6.3%	7.1%	25.2	30.0	14%
----Switzerland	3%	4.0%	4.2%	18.3	24.8	9%
----Germany	3%	5.8%	7.0%	19.5	24.4	10%
----Spain	1%	6.9%	0.0%	18.6	16.3	17%
----Sweden	1%	6.7%	7.8%	17.3	49.2	8%
----Netherlands	1%	6.3%	6.4%	25.4	31.6	12%
----Italy	1%	8.1%	7.7%	76.1	40.5	22%
U.K.	7%	5.8%	4.7%	23.3	25.4	14%
Japan	8%	5.8%	7.9%	17.1	19.4	14%
Australia	3%	6.9%	4.9%	18.9	18.9	7%
Emerging Asia:	7%	2.3%	4.8%	12.8	16.0	12%
----China	4%	4.3%	2.2%	18.1	17.3	18%
----South Korea	1%	1.1%	2.2%	11.9	13.6	11%
----Taiwan	1%	4.3%	4.7%	15.0	27.8	6%
----India	1%	2.3%	10.3%	20.4	17.2	18%
Latin America:	2%	3.9%	-2.7%	15.2	13.7	16%
----Brazil	1%	2.2%	-4.5%	12.0	13.2	17%
----Mexico	0%	7.3%	0.9%	25.2	15.8	13%
CEEMEA:	2%	4.8%	4.9%	9.9	16.2	16%
----South Africa	1%	0.6%	4.7%	14.9	14.1	14%
----Russia	1%	22.8%	21.9%	4.3	7.0	16%
----Turkey	0%	-8.7%	-9.6%	9.9	10.1	16%
----Poland	0%	1.6%	-3.0%	21.3	21.7	6%

3/1/2015	Weight in MSCI ACWI	% chg 1 Month (\$)	% chg YTD (\$)	P/E Ratio Trailing	P/E Ratio 20-yr Avg	2015 EPS Growth (e)
MSCI AC World	100%	5.4%	3.7%	17.5	20.1	13%
Consumer Discretionary	12%	7.2%	6.1%	18.8	25.2	15%
Consumer Staples	10%	3.4%	4.7%	21.6	20.2	9%
Energy	8%	5.1%	-0.1%	14.1	15.2	41%
Financials	21%	6.0%	1.0%	13.3	25.0	10%
Health Care	12%	4.2%	6.7%	24.6	22.5	12%
Industrials	11%	5.8%	3.8%	18.6	21.0	11%
Information Technology	14%	6.9%	4.6%	18.9	33.6	11%
Materials	5%	7.8%	6.8%	20.2	19.9	18%
Telecom	4%	4.1%	5.3%	18.9	53.6	5%
Utilities	3%	-3.4%	-2.8%	18.1	16.5	5%

Source: Cornerstone Capital Inc., Bloomberg

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