

The search for growth

Opportunities and risk for institutional investors in 2012

A report from the Economist Intelligence Unit

About the research

The Search for Growth is the second in an annual series produced by the Economist Intelligence Unit, and sponsored by BNY Mellon. The research aims to paint a picture of the global economy and investment market that is unfolding in 2012, and to explore where investors are looking for growth opportunities in today's tepid market environment.

The research is based on two main initiatives. In January 2012 the Economist Intelligence Unit conducted a survey of nearly 800 institutional investors and corporate executives. The

respondents were drawn from 77 countries. To complement the survey results, the Economist Intelligence Unit carried out a series of in-depth interviews with leading global pension sponsors, non-profit portfolio managers, economists and private equity and hedge fund managers.

The Economist Intelligence Unit bears sole responsibility for the content and the findings, and the views expressed here do not necessarily reflect those of the sponsor. The report was written by Eric Laursen and edited by Annabel Symington. ■

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Scenario analysis

This chart shows respondents' assessment of the likelihood and impact of a range of scenarios on their portfolio or company along two vertical axes.

LIKELIHOOD

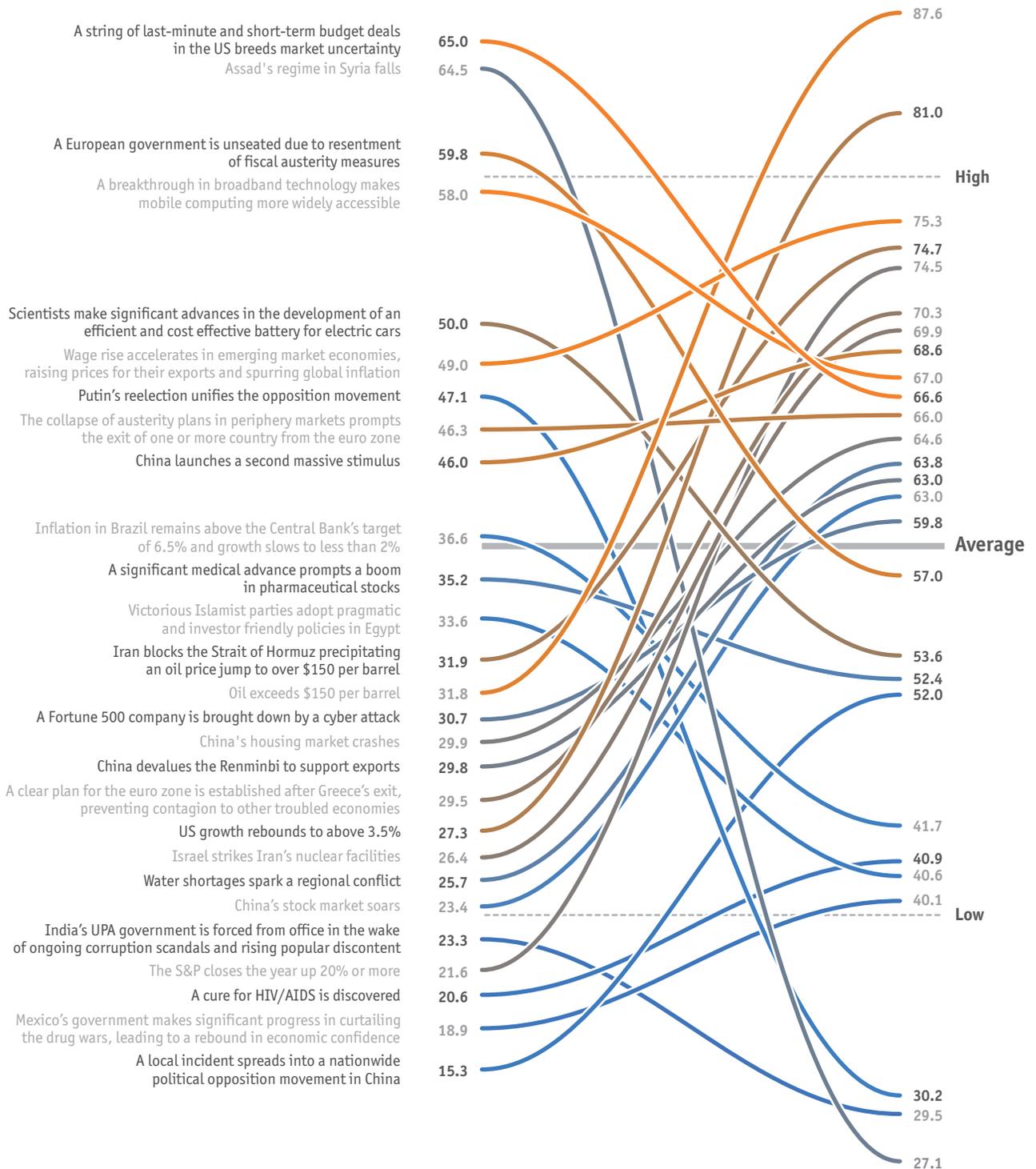
(% of respondents, likelihood of scenarios, quite likely and very likely)

High likelihood
High Impact

Low likelihood
Low Impact

IMPACT

(% of respondents, impact of scenarios, negative and positive)



Source: Economist Intelligence Unit Survey, January 2012



Introduction

Global investors have replaced the bullish outlook many expressed in early 2011 with a more tempered optimism. Global economic prospects continue to improve, thanks to aggressive action by the European Central Bank (ECB), which has partially stabilised the euro zone. This has also reduced pressures in the US, and latest economic data suggests a glimmer of hope. However, significant risks continue to be posed by the euro zone's peripheral markets, and following a series of missteps by the Spanish government the euro zone crisis is threatening to return to the fore.

While investors appear buoyed by recent events, the fundamentals of the global economy have not improved significantly, and new risks have arisen to replace older ones. The recent rise in the price of crude oil, tied in part to tensions over Iran's nuclear programme, has emerged as the main obstacle to global growth—at least for the moment. Even in the absence of military action, this is already creating headwinds for oil-dependent economies, particularly the US.

The optimism displayed in this year's survey of global institutional investors may be explained by timing: the survey was conducted during the stockmarket rally that opened 2012. At this point, much of the positive economic news may already be priced into the market, and downside risks remain very large. This raises the question: are investors pinning too much hope on what appears to be just a slight respite in financial markets?

Responses from the survey indicate that investors believe the principal risks the market will face in 2012 relate to geopolitical events rather than strictly market-based developments. They also suggest that some positive surprises may be hovering in the wings: over half (58%) of respondents say that a breakthrough in broadband technology that makes mobile computing more widely accessible is likely, and 66% say that this would have a positive impact on their portfolio. However, there is undoubtedly a recognition that the fragile post-2008 economy will linger for some time. ■



Executive summary

According to the Economist Intelligence Unit's second annual *Search for Growth* survey, sponsored by BNY Mellon, global investors feel moderately optimistic about growth prospects over the next 12 months. This is largely attributable to the apparent stabilisation of the European debt markets, which is buying time for EU member states to engineer an economic recovery, as well as signs of a modest improvement in the US and the relative resilience of emerging markets to a global slowdown. But opinions among survey respondents and interviewees vary widely according to region—unsurprisingly given the dramatically different growth prospects of emerging Asian and euro zone countries.

Notable conclusions from the research include:

- **Investors see some opportunities in global financial markets.** Among survey respondents, 85% perceive significant opportunities, although 51% acknowledge that there are major downside risks. Some easing of the European debt crisis, coupled with a somewhat better economic performance in the US, has created a more stable outlook for financial markets—though this relief may prove to be short lived.
- **Geopolitics rather than market forces will govern the outcome in 2012.** Hopes for further improvement hinge less on economic activity generated by the private sector than on

governments' ability to play their geopolitical roles properly. This has been proven by a series of political misjudgements in Spain that have eroded the recovery in investor confidence that accompanied the injection of more than €1trn into regional financial institutions by the European Central Bank (ECB). The Economist Intelligence Unit's forecast still places the threat of an oil price spike, tied in part to tensions over Iran's nuclear programme, as the main obstacle to global growth. Respondents agree that an oil price rise to above \$150 per barrel would have the greatest impact on their portfolio or company of all scenarios included in this year's survey, selected by 88% of respondents.

- **High levels of debt continue to be a major concern.** Over the next 12 months debt levels are unlikely to change, but debt continues to restrict the world economy's recovery from the 2008 global economic crisis.
- **Low levels of capital investment temper opportunities.** Less than half (45%) of respondents think that businesses will increase capital investment in 2012. Respondents from the US, where the economy is slowly improving, appear slightly more optimistic, while the majority of euro zone-based respondents expect to see capital investment decrease or remain the same as in 2011. Corporations based in the euro zone are estimated to hold an unprecedented €2trn

(US\$2.6trn) in cash, with those based in the UK holding £750bn (US\$1.2trn), according to the Institute of International Finance. This, combined with high risk premiums in some markets, the sustained efforts by banks to build capital buffers and the continued deleveraging by highly indebted households, will hold down investment and consumption until 2013, when growth will return—but feebly.

- **The US finds favour as stable middle ground.**

With GDP forecast to grow modestly, investors now see the US as offering an attractive risk/reward trade-off. In this year's survey the US moves from fourth to third place for asset price growth, with 40% of respondents placing it among their top three markets.

- **Slower growth in China and India shifts attention to smaller emerging economies.**

Smaller economies are likely to benefit from demographic trends—such as relatively young populations—as well as economic or political factors such as low wage costs, low public and private debt levels, rising domestic consumption and deepening financial markets. South-east Asia, in particular, is attracting investor attention, replacing Brazil in fifth position among markets offering the best opportunities for asset price growth this year.

- **Investor sentiment echoes grim forecast for the euro zone.** Even if the current strains in the euro zone ease, the region's fundamentals look no better than they did a year ago. The periphery is uncompetitive, debt levels remain high, banks across the euro zone are under-capitalised and austerity measures will exacerbate recession. Cohesion between the governments of the single currency zone appears unattainable. Reflecting this, only 17% of survey respondents consider the

EU among their top markets for asset price growth in the next 12 months. More than 60% expect the euro itself to decrease in value—the worst projected performance for any currency covered in the survey and a dramatic turnabout from 2011, when 53% of respondents expected the euro to appreciate.

- **European investors are more optimistic than the global aggregate about the euro zone's future.** Almost half (47%) of survey respondents agree that an austerity plan is likely to collapse in one or more peripheral euro zone countries, prompting the exit of one or more in the next 12 months. But less than one-third (29%) of European investors think this scenario is likely. The difference of opinion is perhaps in part because firms used to transacting most of their business in the euro area for the past decade have more to lose from its dissolution.

- **Investors move away from commodities.**

Lower demand for many raw materials from sluggish developed markets in the euro zone and elsewhere is pushing investors away from commodities. Another reason, according to some investors, may be a desire by large institutions to concentrate on highly liquid assets during a time of uncertainty.

- **Positive opportunities in the wings?** There is undoubtedly a recognition that the fragile post-2008 economy will linger for some time, but responses from the survey indicate that investors believe that some positive surprises may be hovering in the wings: over half (58%) of respondents say that a breakthrough in broadband technology that makes mobile computing more widely accessible is likely—and 66% say that this would have a positive impact on their portfolio. ■

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