

Consolidation of optimism

Recession risk reduced

September FMS sees further gains for the bulls as investors continue to gradually embrace global economic recovery. Less than a third of investors now see the global economy in recession compared to two-thirds only 2 months ago.

Goldilocks back in town

Investors remain cautious on strength of recovery; 72% believe we are heading for below trend growth and inflation. The tail risks i.e. deflation or inflation have become much less consensus (only a net 3% believe in either scenario).

Micro story improving

There is growing belief in margin story. In two months corporate operating margin expectations have jumped from -3% to +38%. Views on corporate profits 12 months out (net +68% versus +70%) are positive but again are not yet exuberant (previous recoveries have seen sustained readings above 80%). There still appears to be residual reluctance to fully embrace a robust recovery story.

Risk appetite held in check: cash balances refreshed

Despite improvement in the macro backdrop there is reluctance to get too carried away. Risk & Liquidity indicator at 40 i.e. average reading for the past eight years. Cash balances rose to 4.1% from 3.5%. A net 18% of all investors are OW cash in portfolios, up from +10% in August.

Inflation views bond supportive

September saw inflation expectation over next 12 months drop from a net 30% last month to a net 21%, helping explain how bonds are rallying despite growing economic optimism. 70% of investors still see higher short rates 12 months out.

Allocation broadens out; GEM no longer only game in town

GEM remains strongly OW in regional allocation but fell to +40% from +52%, as Eurozone was raised to only 1% UW (from -13%), the highest reading since Feb 2008. EU is now #2 region investors want to OW on a 12 month view. Also GEM investors are now net UW on China (-9%) after 13 months of net OW.

Defensive sector capitulation but where to go long?

The big 4 defensive sectors are all now UW (as noted in June) which may prompt rotation at the expense of the two big consensus OW of tech (+31%) and energy (+27%). Outside of these, investors cut exposure to the strongly performing materials and industrial cyclical sectors leaving only modest cyclical exposure.

Contrarian long & shorts

Contrarian longs: Japan, UK & EU consumption, EU banks, utilities in almost every region, GEM materials, real estate. *Contrarian shorts:* US, EU, Japan, Asia tech, EU energy, EM consumer, Russia, Brazil.

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Notes on the Survey

Survey period 4th – 10th September. An overall total of 326 panellists participated. 234 participants with \$667bn AUM responded to the Global FMS questions.

Only participants in the survey can receive the full data but only for the relevant month in which they participate.

Investors/clients are encouraged to sign up to participate in the Survey. This can be done by contacting Gary Baker, Michael Hartnett or your Merrill Lynch sales representative.

Notes to Readers

Source for all tables and charts:
Merrill Lynch Fund Manager Survey,
Datastream.

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Refer to important disclosures on page 18 to 20.

Table 1: Markets between fieldwork periods

	4 th – 10 th	7 th – 12 th	2 nd – 9 th
% change in	Sep	Aug	Jul
World Equities	3.5	13.0	-4.9
Dow Jones	2.0	13.3	-6.0
US 10y Bond (bps)	-8.6	9.2	-11.3
Commodities (CRB)	-2.1	8.1	-6.8
Crude Oil-WTI	-0.4	11.1	-9.8
Trade Weighted Dollar	-2.3	-1.8	0.2
CBOE VIX (level)	25	25	29

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Survey sound bites

The fieldwork for the September survey took place between Friday 4th, and Thursday 10th September 2009.

Growth expectations

Fund manager optimism on global economic prospects consolidated this month as our growth composite indicator was little changed from last month of 86 to 85. This was maintained despite continued reversal in China economic optimism since July as the % of regional PMs expecting stronger China growth fell to 35% from 49% last month.

This month we see investors continue to gradually embrace global economic recovery. Less than a third of investors now see the global economy in recession compared to two-thirds only 2 months ago. However it seems Goldilocks is back in town as investors remain cautious on strength of recovery; 72% believe we are heading for below trend growth & inflation. The tail risks i.e. deflation or inflation have become much less consensus.

There is growing belief in margin story. In two months corporate operating margin expectations have jumped from -3% to +38%. Views on corporate profits 12 months out (net +68% versus +70%) are positive but again are not yet exuberant (previous recoveries have seen sustained readings above 80%). There still appears to be some reluctance to fully embrace a robust recovery story.

Inflation expectation over next 12 months has dropped from a net 30% last month to a net 21%, helping explain how bonds are rallying despite growing economic optimism. 70% of investors still see higher short rates 12 months out.

Risk appetite

Despite improvement in the macro backdrop there is reluctance to get too carried away. Risk & Liquidity indicator is at 40 i.e. average reading for the past 8 years. Cash balances rose to 4.1% from 3.5%. A net 18% of all investors are OW cash in portfolios, up from +10% in August.

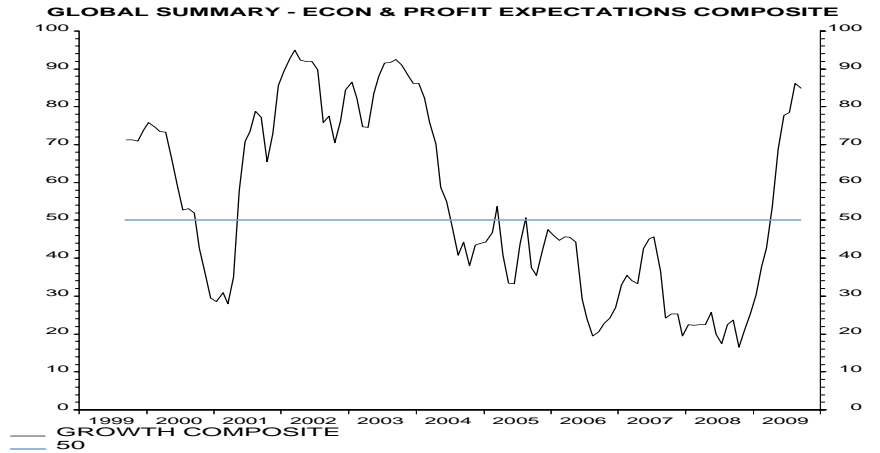
Valuation & Regional and Sector preference

Asset allocators now see Equities as undervalued (net -4% against the net 1% overvalued last month). However they continue to see bonds as overvalued with net 38% against 34% last month.

GEM remains strongly OW in regional allocation but fell to +40% from +52%, as Eurozone was raised to only 1% UW (from -13%), the highest reading since Feb 2008. EU is now #2 region investors want to OW on a 12 month view. Also GEM investors are now net UW on China (-9%) after 13 months of net OW.

On sectors we see defensives capitulation as the big 4 defensive sectors are all now UW (as also noted in June) which may prompt rotation at the expense of the two big consensus OW of tech (+31%) and energy (+27%). Outside of these, investors cut exposure to the strongly performing materials and industrial cyclical sectors leaving only modest cyclical exposure.

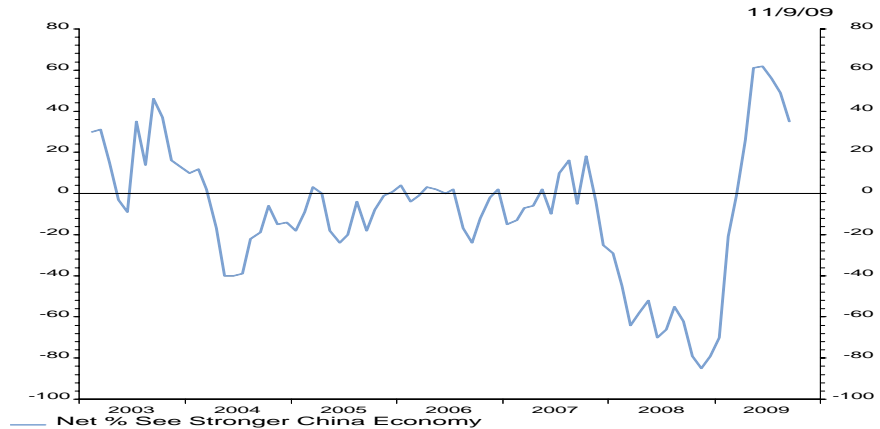
Chart 1: Growth Expectations Composite – Global FMS



Consolidation in growth optimism but not at stretched levels. The 2003 recovery saw consistent readings above 80%.

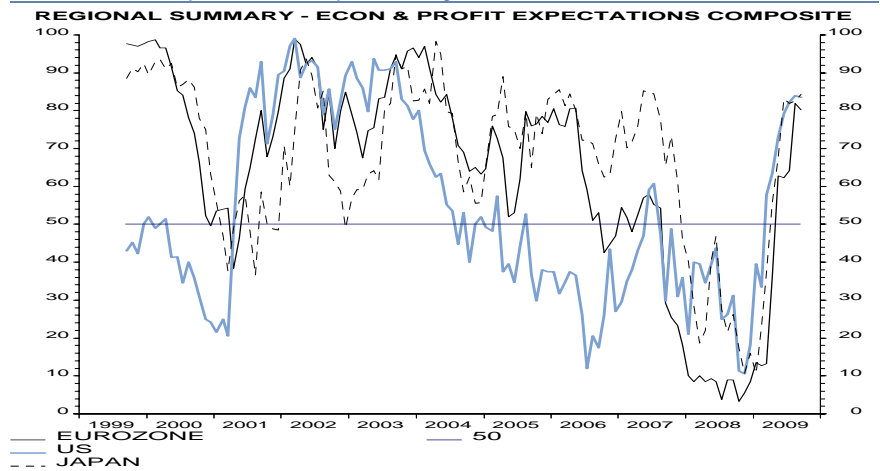
The composite growth indicator combines the outlook for economic activity with the expectations for corporate profit growth.

Chart 2: Net % of regional FMs expecting stronger Chinese economy



Despite further moderation in views on China prospects (down to +35% from +49%)...

Chart 3: Growth Expectations Composite – Regional FMS



... a broadening out of optimism on global growth remains a feature of the survey with little to choose between regions.

Japan (84 from 83)
Eurozone (80 from 82)
US (84 from 84)

Chart 4: Fund Managers' Growth Expectations & OECD Leading Indicator

The lead indicator status of the FMS expectations lead indicator shows no signs of retreat

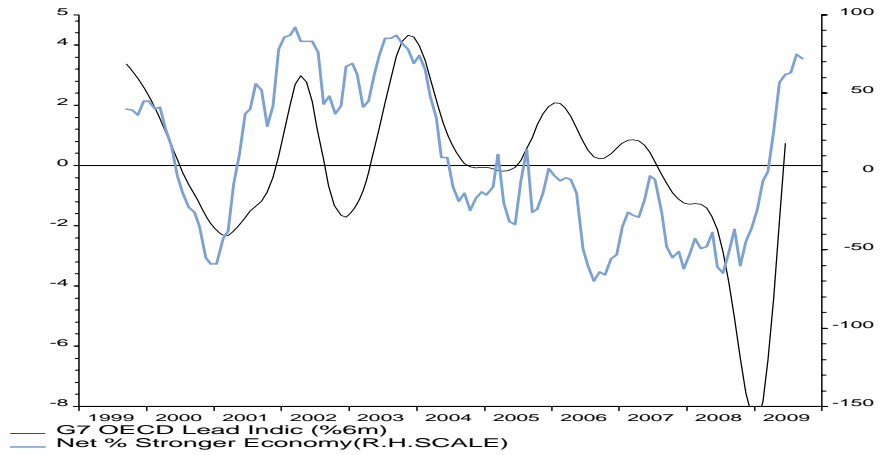


Chart 5: Profit expectations

Corporate profit expectations saw the first correction (a minor one to 68 from 70 last month) since turning up in October 2008.

61% of fund managers now believe global corporate earnings can rise by >10% over the coming 12 months.

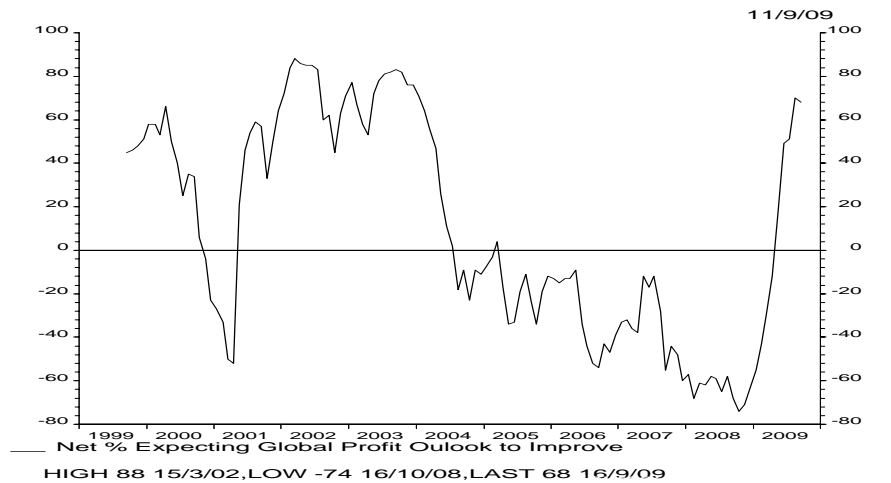


Chart 6: What would you most like to see companies doing with cash flow?

Investors remain fairly sanguine about what corporates should be doing with cash flows. The clear majority is still focused on balance sheet repair and then capex rather than return to shareholders

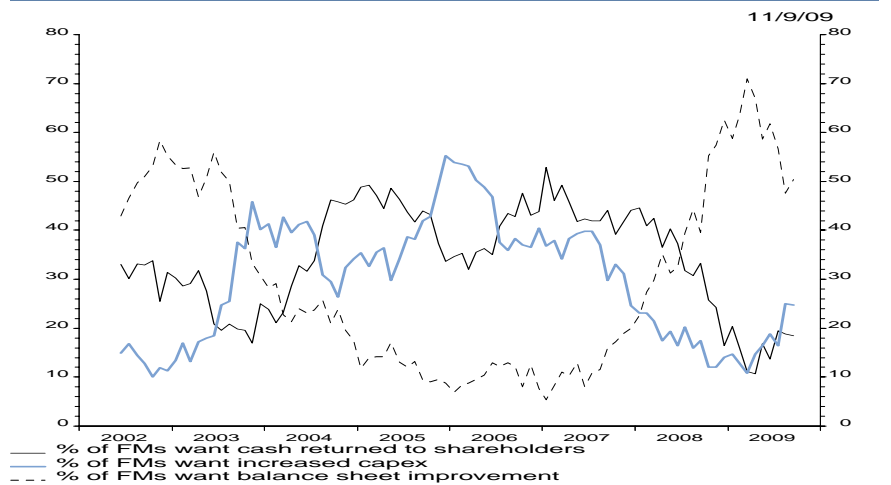


Chart 7: Phases of the Global Economic Cycle, In Degrees*

To track how managers view progress through the economic cycle, we've expressed their responses as if positioned on a circle. We have positioned "recession" at 360°, "early cycle" at 450°, "mid-cycle" at 180° and "late cycle" at 270° and calculated an overall position from those four locations.

Similar to other periods as the economy passes through cyclical turning points, once a tipping point is reached momentum picks up sharply as recession fears recede.

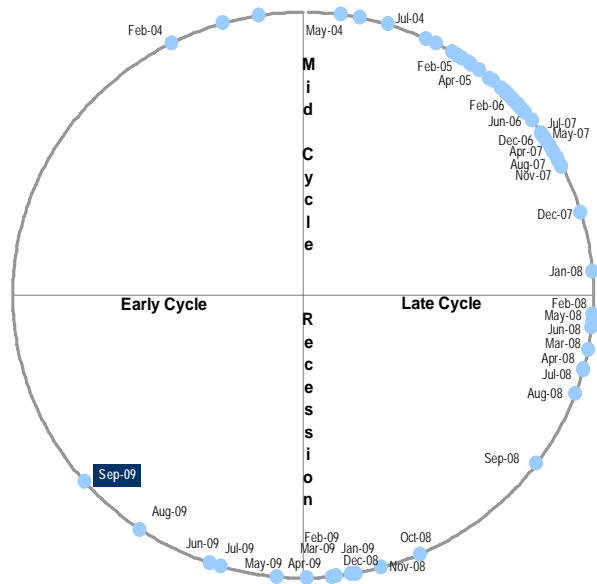
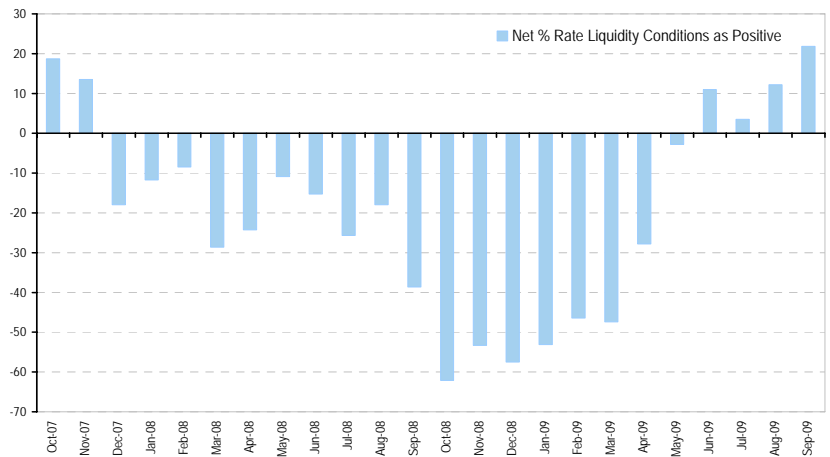


Chart 8: How would you rate liquidity conditions (e.g. depth of markets, narrowness of bid-offer spreads, ease of execution etc) at this time?

Liquidity and functioning of markets is now seen as positively healthy certainly compared to the lows of late last year.

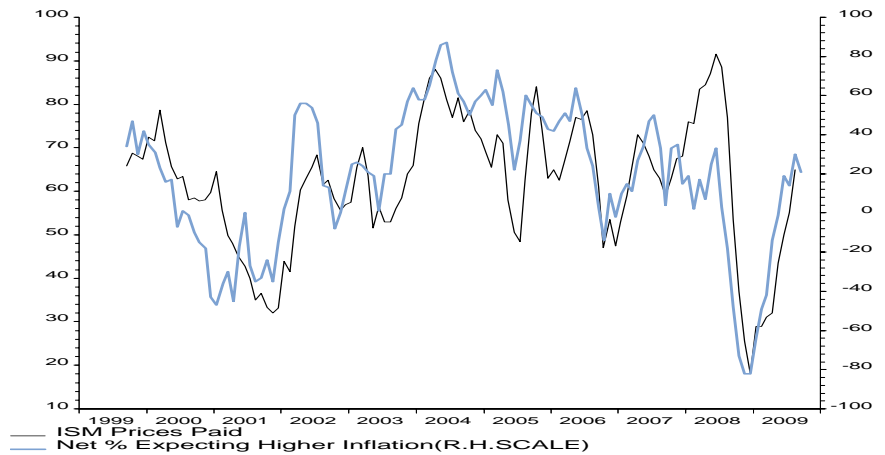


Inflation and interest rates

Inflation expectations moderated this month after a sustained 10-month rally, although not sufficiently to shift views on the direction of short-term rates.

After a virtually uninterrupted rise in inflation expectations since the turn of the year, September showed a marked fall to +21% from +30%. Within the big picture it still looks like a minor correction in a trend that continues to hug the ISM prices paid data series.

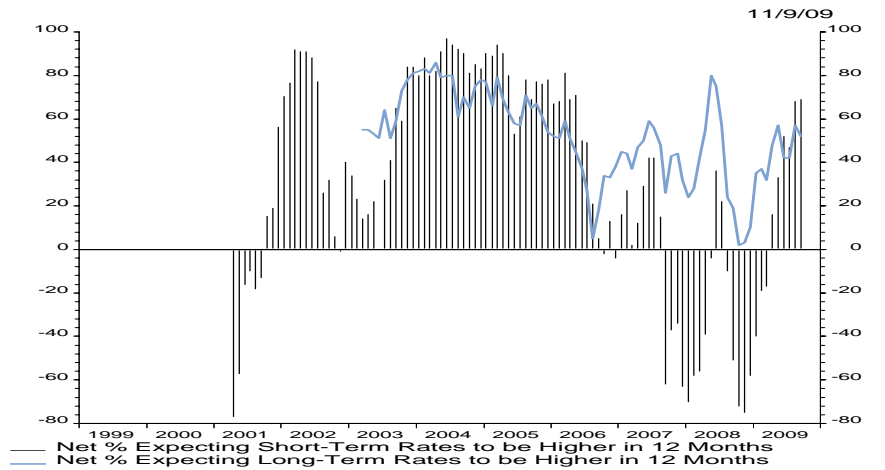
Chart 9: Inflation expectations and ISM 'Prices Paid'



A moderation in inflation expectation failed to dent the belief that short rates will be rising in the coming 12 months (+69% versus +68%).

Expectations on long term rates abated some what to +52% from +57%.

Chart 10: Expectations for long and short-term interest rates



Risk Appetite

Chart 11: The ML FMS Risk & Liquidity Composite Indicator

Chart 11 presents an overall view of Risk & Liquidity, combining readings on risk appetite, investor time horizon and cash weightings.

However much investors believe we are through the worst economically, risk appetite remains firmly controlled standing at exactly the average of 40 we have seen in this indicator since introduction in 2002.

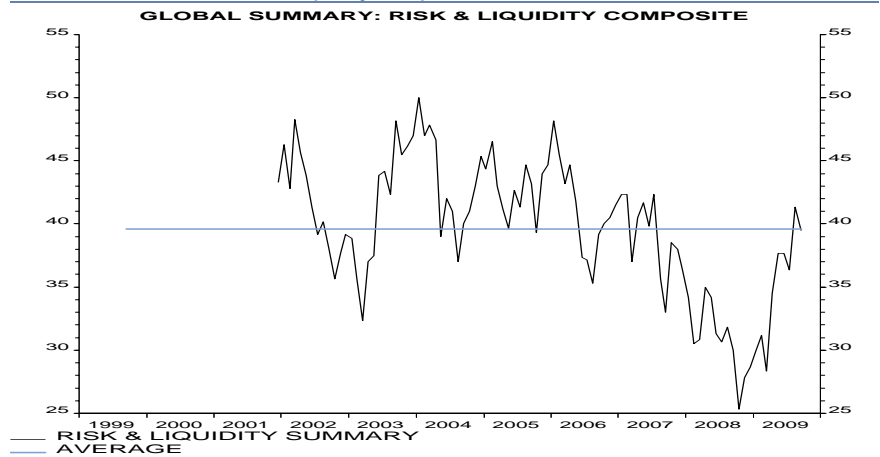


Chart 12: Hedge Fund positioning

Chart 12 poses two questions to hedge fund panellists: what is the current ratio of your gross assets relative to your capital, and what is your current net exposure to the equity market (long minus short as % of capital).

Hedge fund activity according to the survey remains subdued with gross exposure rose maintained at 1.0x and net exposure at 31%, both readings registering the same levels as last month.

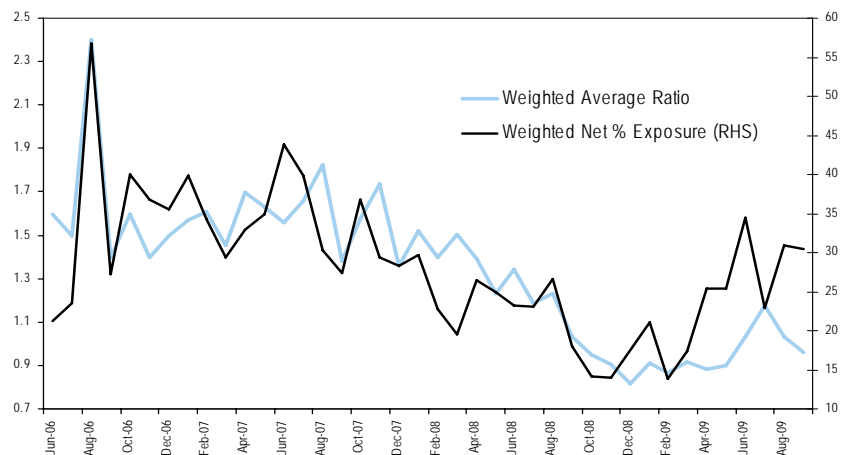
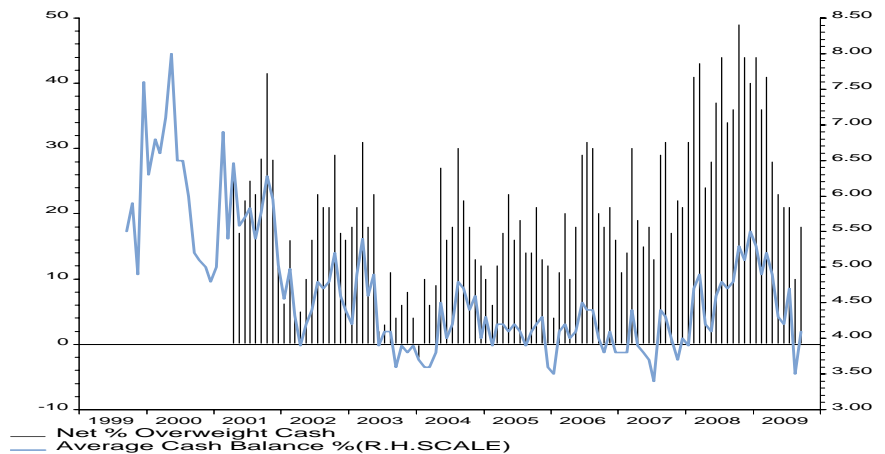


Chart 13: Net Overweight Cash and Mean Cash Balance

FMS questions on cash positions address both global investors and asset allocators.

At the global level, there was a rebuild of cash levels to 4.1% from the low of 3.5% in August. Those OW cash rose to net 18% from 10% last month.

Asset allocators confirmed this trend with cash OW rising to net 10% from +3%.



Asset allocation: current positions

Having bitten the bullet in significantly raising equity weightings last month, asset allocators trimmed back somewhat in September with equities falling to +27% OW and bonds 26% UW. The rehabilitation of real estate continued with the net UW falling to 9% from 15%.

Chart 14: Cash*

In charts 14-16 we plot the performance of each asset class relative to a synthetic asset allocation benchmark comprising: 60% global equities, 30% global bonds and 10% US cash. The base currency is USD.

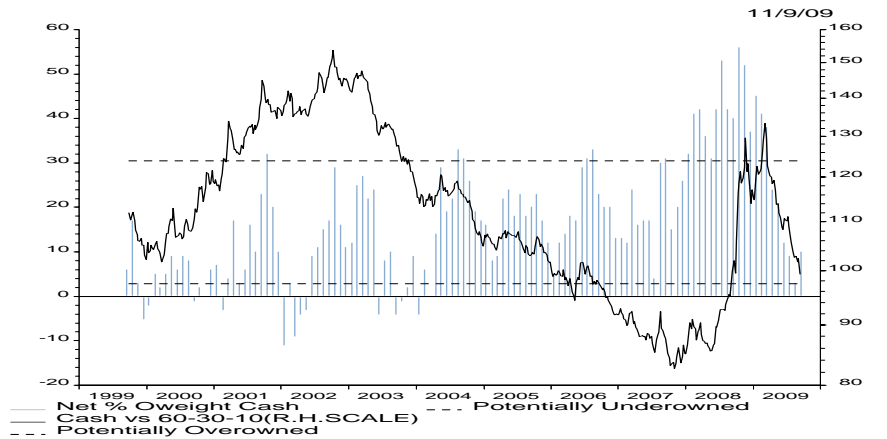


Chart 15: Equities*

While still overweight equities at +27%, this is down from last months recent high of +34%.

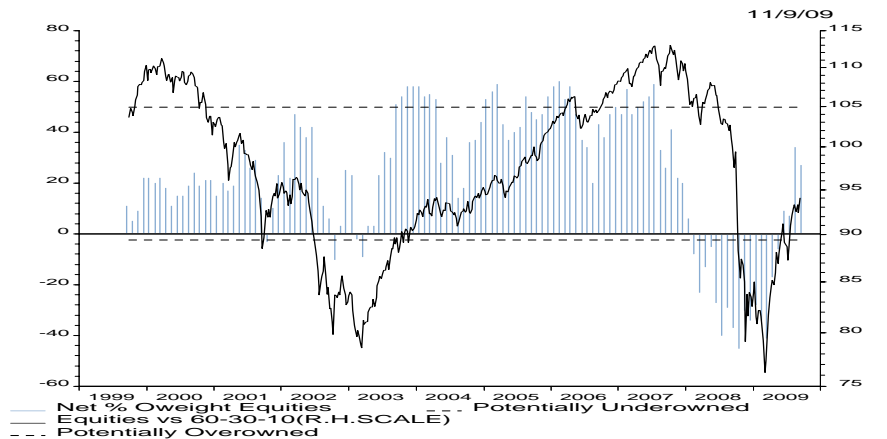
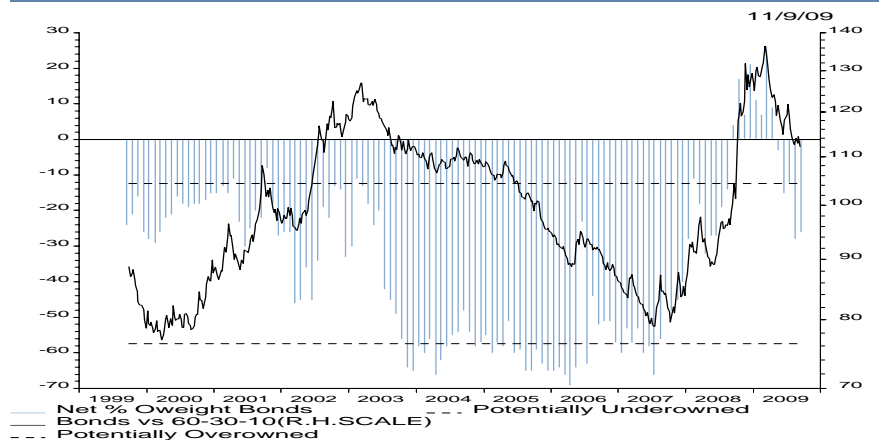


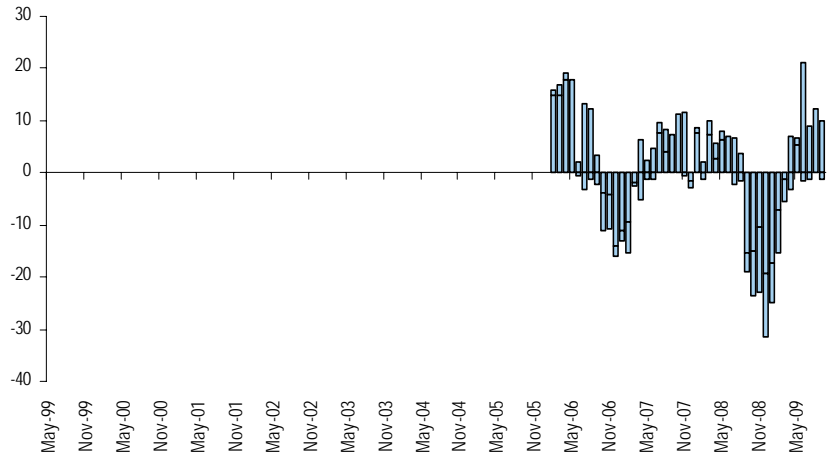
Chart 16: Bonds*

...bonds saw a marginal improvement to a net UW of 26% compared to -28%



Growing interest in real estate is reflected in further improvement in net UW to -9% from -15% and -24% in July

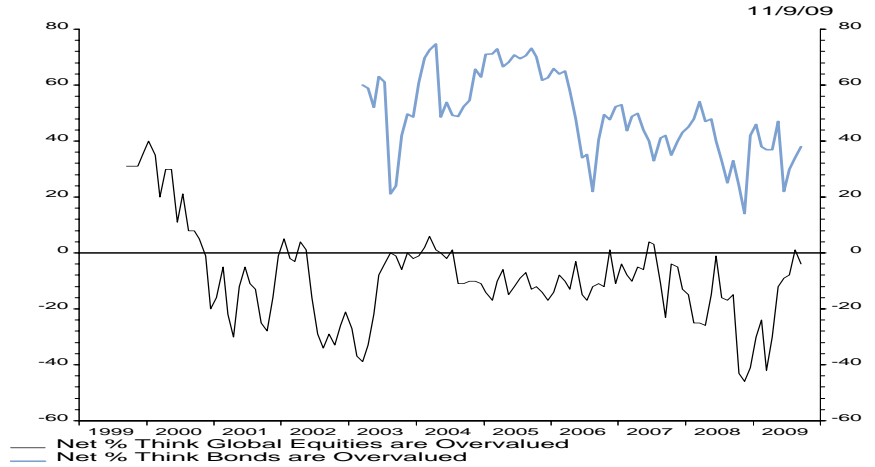
Chart 17: Commodities



Relative Valuation

No real change in views on equities being about fairly valued but bonds, after a recent rally, are now seen as more overvalued (+38% vs. +34%)

Chart 18: Equity market valuation vs. bond market valuation



Global sectors

September saw a return to the picture seen in June of all big 4 defensive sectors (telecoms, pharma, utilities and staples) being underweight. However, conviction on sector overweights remaining very focused on just two sectors: technology and energy.

Table 2: Changes in global sector positioning

	MoM Chg
Banks	6
Tech	3
Energy	0
Insurance	-1
Telecoms	-4
Industrials	-5
Pharma	-5
Utilities	-7
Materials	-11
Staples	-11
Discretionary	-16

Chart 19: Current Sector Positioning

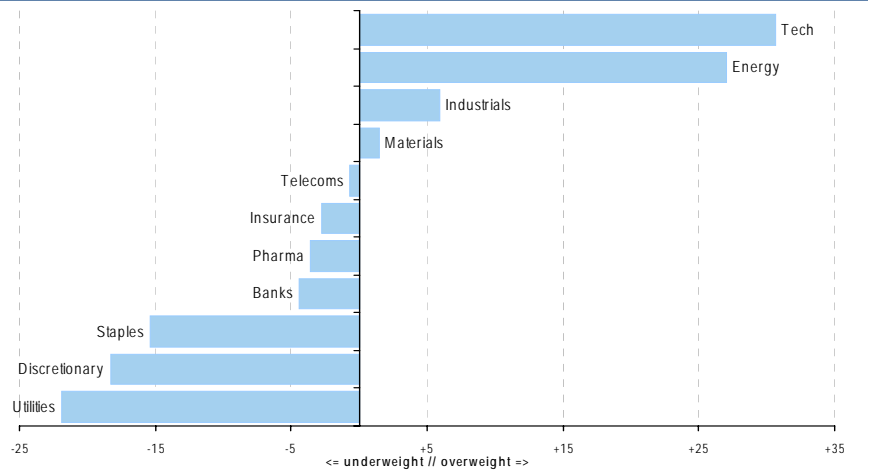
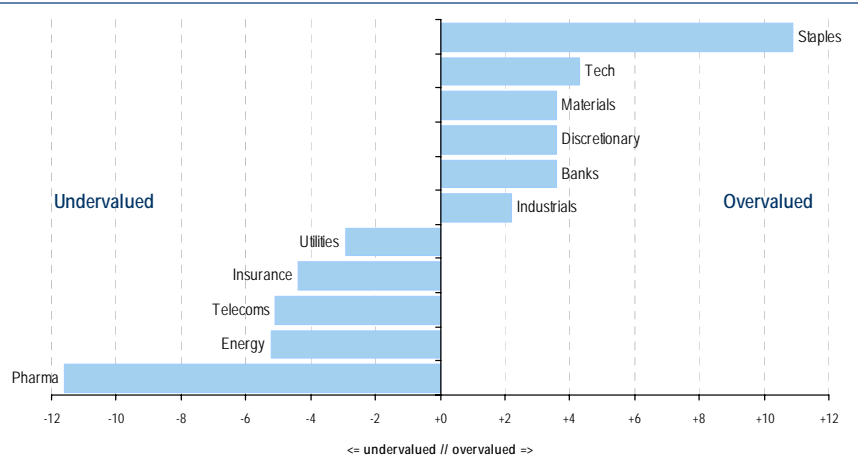


Table 3: Changes in global sector valuation

	MoM Chg
Banks	9
Industrials	6
Staples	6
Tech	3
Telecoms	2
Materials	-1
Energy	-4
Insurance	-4
Utilities	-4
Discretionary	-5
Pharma	-5

Chart 20: Sector Valuation Assessment

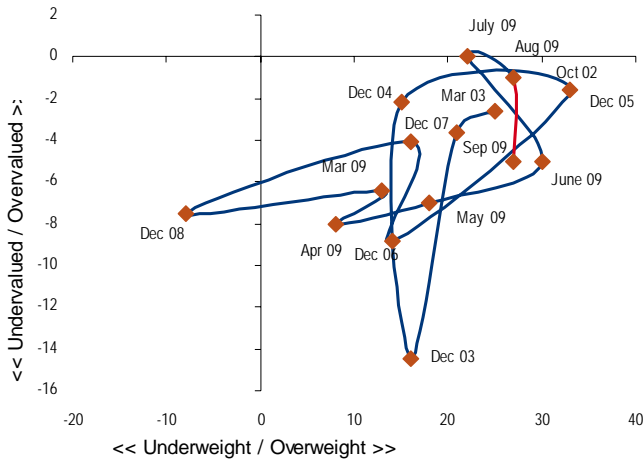


Sector changes through time

Charts 21-24 show a longer-term perspective on FMS sector positioning linked to our report [European Equity Strategy, 24 March 2009](#). They provide a map (or Rorschach picture for those so inclined) looking at movement in sector positioning/valuation over the course of the last market cycle.

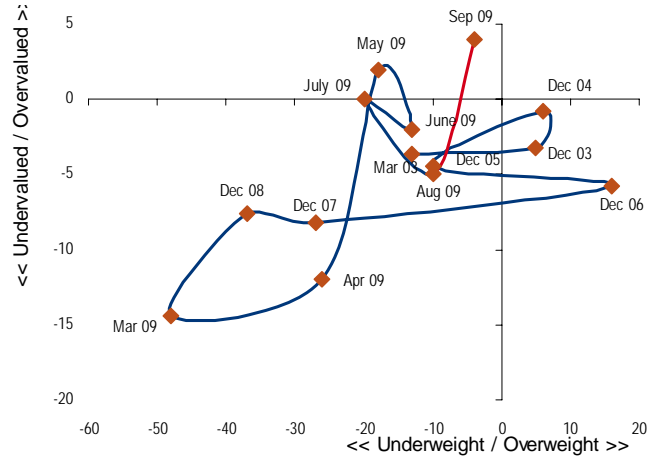
The charts highlight the continuing decline in support for defensive bellwethers such as Pharma and staples as well as the persistent positive view on energy (typically always undervalued and OW) contrasting with the relative confusion in views on banks.

Chart 21: Sector Valuation vs. Positioning Trail – Global Energy



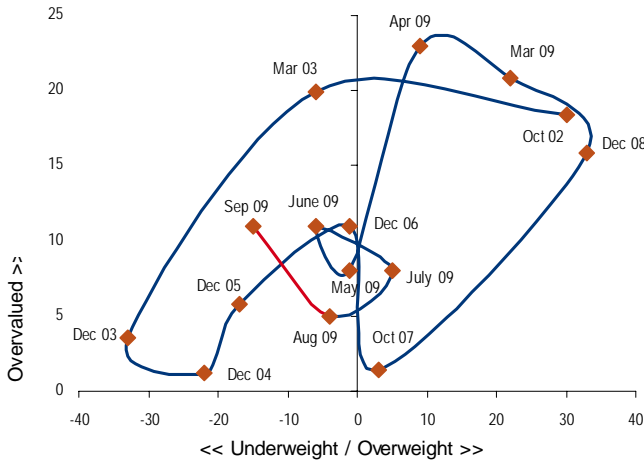
Source: Merrill Lynch Fund Manager Survey

Chart 22: Sector Valuation vs. Positioning Trail – Global Banks



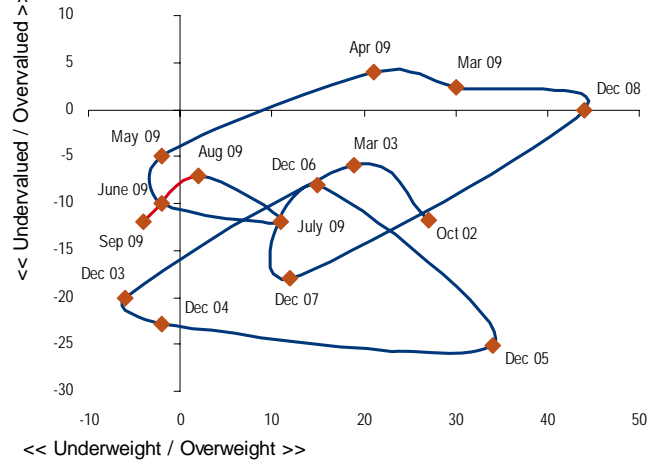
Source: Merrill Lynch Fund Manager Survey

Chart 23: Sector Valuation vs. Positioning Trail – Global Staples



Source: Merrill Lynch Fund Manager Survey

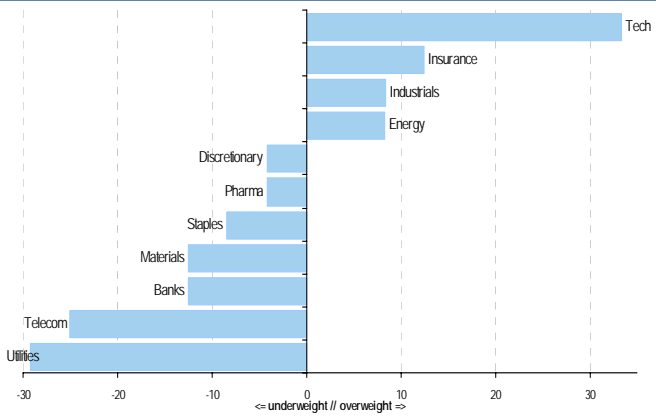
Chart 24: Sector Valuation vs. Positioning Trail – Global Pharma



Source: Merrill Lynch Fund Manager Survey

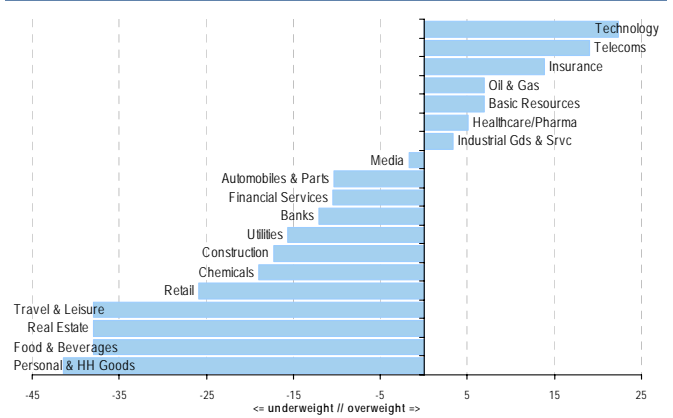
Sector Positions - by Region

Chart 25: U.S.



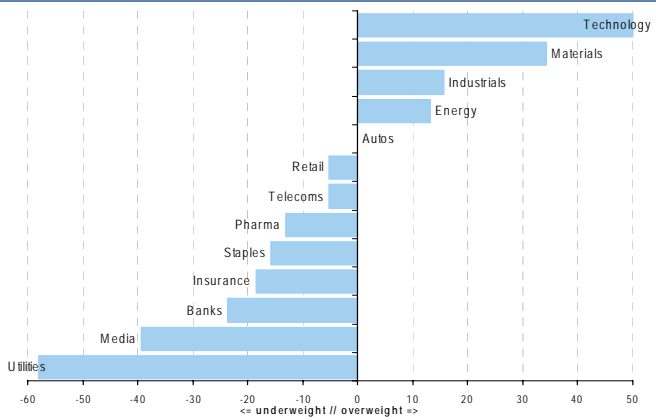
Source: Merrill Lynch Regional Fund Manager Survey

Chart 26: Europe



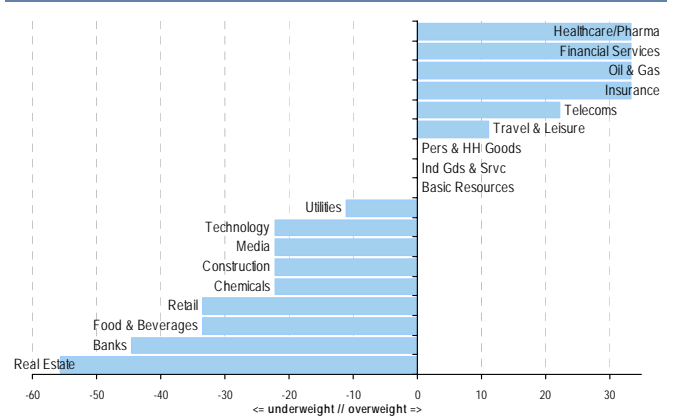
Source: Merrill Lynch Regional Fund Manager Survey

Chart 27: Japan



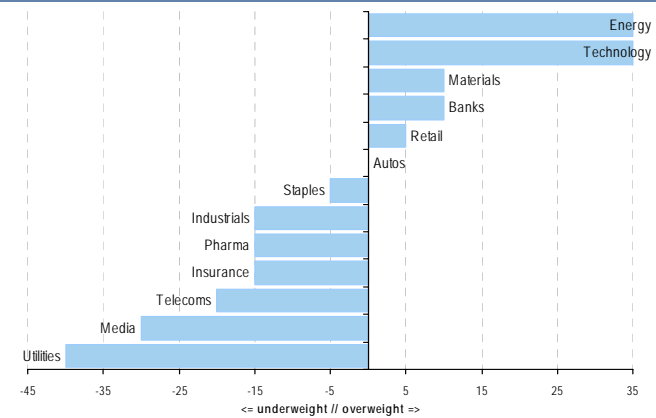
Source: Merrill Lynch Regional Fund Manager Survey

Chart 28: UK



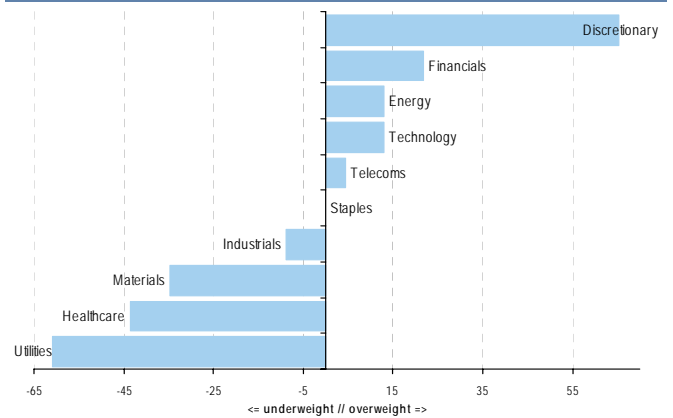
Source: Merrill Lynch Regional Fund Manager Survey

Chart 29: Pacific - ex Japan



Source: Merrill Lynch Regional Fund Manager Survey

Chart 30: GEM



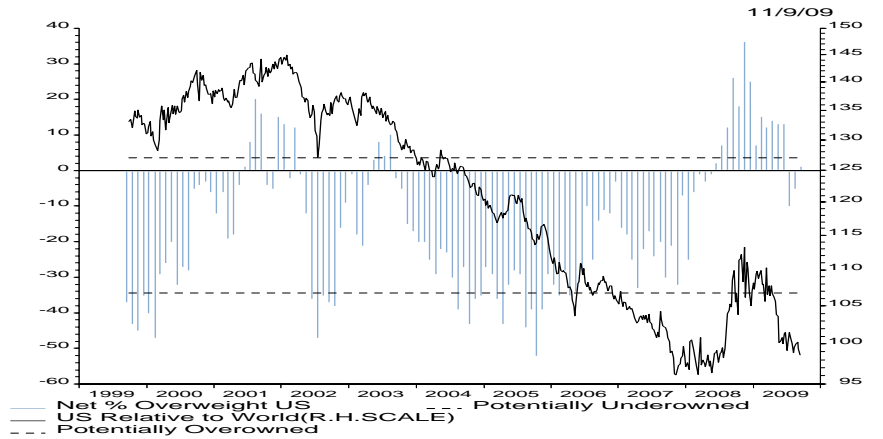
Source: Merrill Lynch Regional Fund Manager Survey

Equities: regional allocation

A broadening out in regional preferences continued this month as the GEM overweight fell to the lowest level in 5 months with Eurozone being the beneficiary reaching its highest level in 18 months. The US saw a modest improvement back to marginally OW.

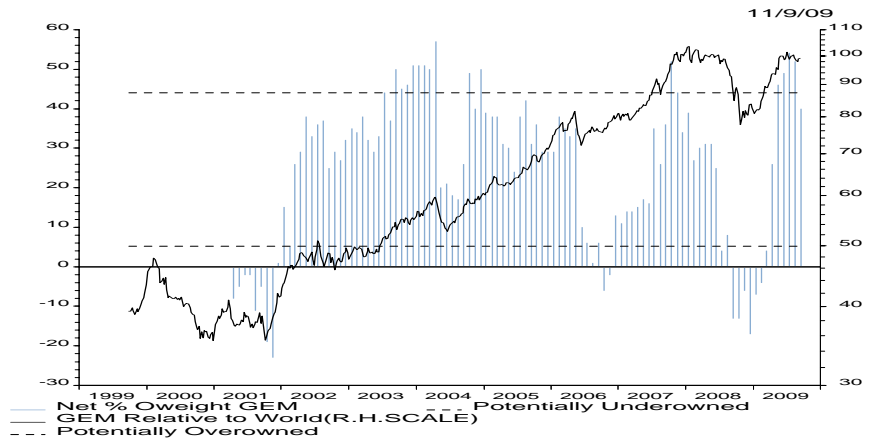
The brief period of US being UW in portfolios ended with a reading of net 1% OW.

Chart 31: U.S. Equities



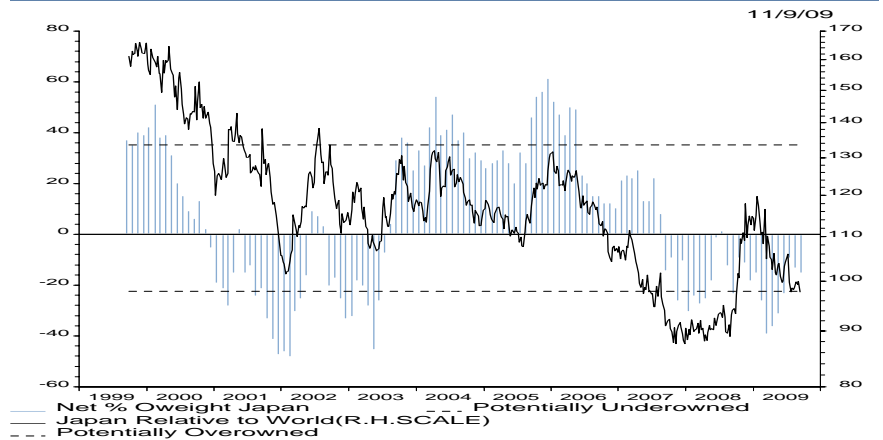
Although still by far the most popular region GEM OW fell to +40% from +52%. A net 29% of investors still see it as the region they want to OW on a 12 months view.

Chart 32: Global Emerging Markets Equities



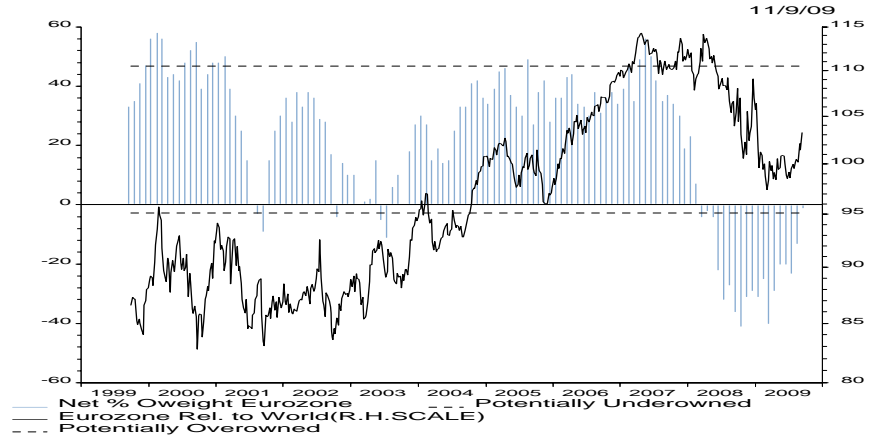
Despite improving macro sentiment, investors remain reluctant to really boost weightings to Japan which is still a net 15% UW in the survey and the least favoured region on a 12 month view.

Chart 33: Japanese Equities



The biggest change in regional preference was seen in EU which although still marginally UW (1%) reached its highest reading since February 2008.

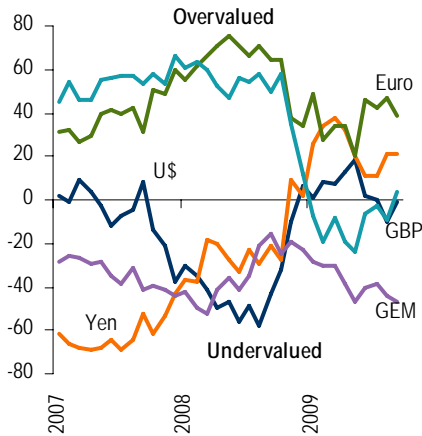
Chart 34: Eurozone Equities



Currency valuation

With the USD seen as fairly valued, currency conviction remains focused on GEM undervalued versus EUR, JPY and now GBP overvaluation.

Chart 35: Net % saying currency overvalued



Despite some weakness recently, USD is seen as less undervalued this month (-1%) than last (-10%).

The Yen is still seen as overvalued (21%).

Conviction on EUR over valuation remains relatively high at (+39%) albeit down on august (47%).

Chart 36: Perception of USD valuation & Trade Weighted

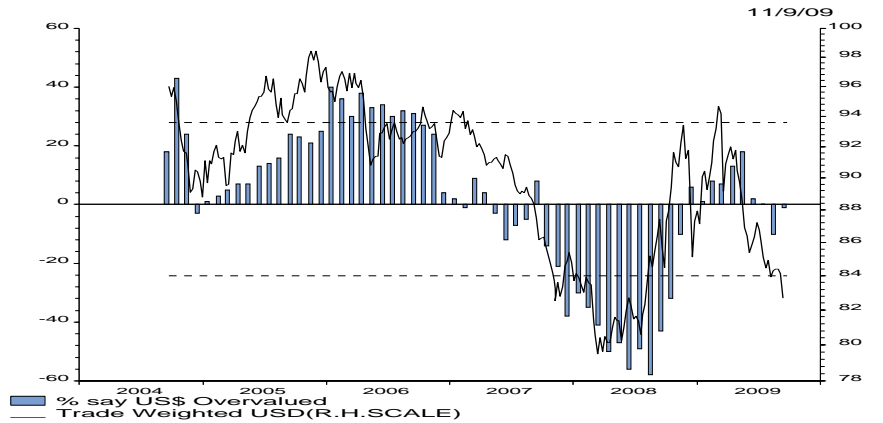


Chart 37: Perception of JPY valuation & Trade Weighted

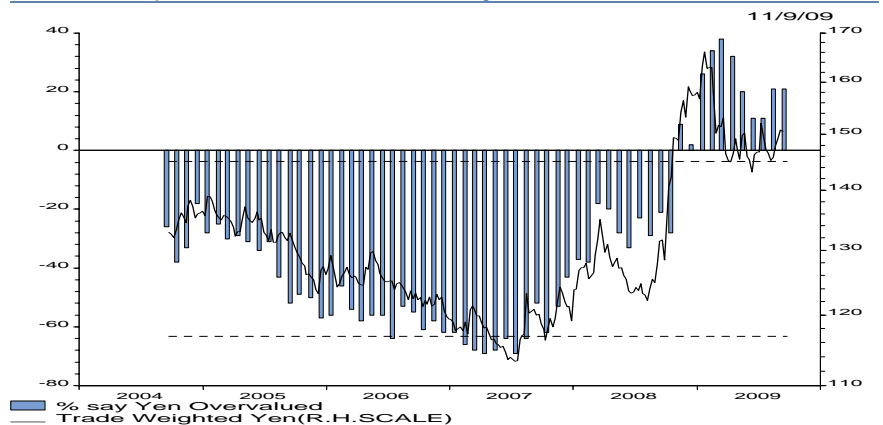
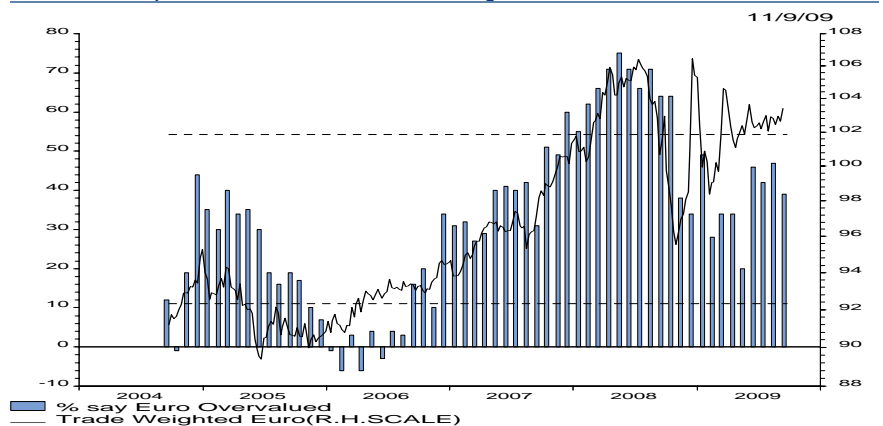
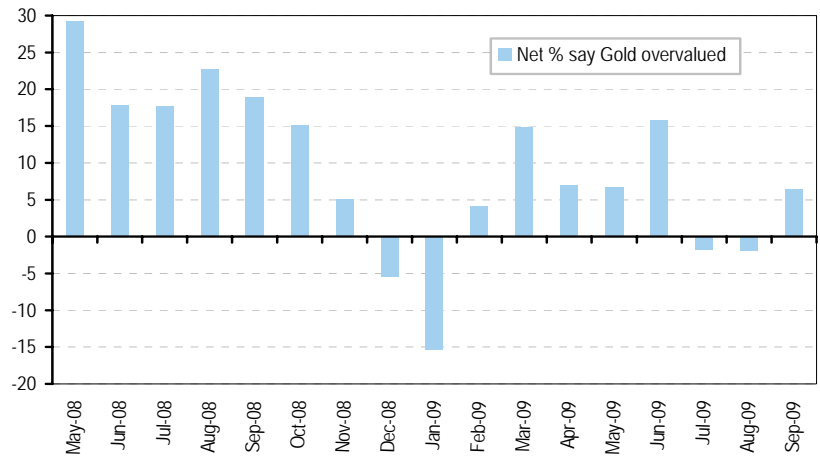


Chart 38: Perception of EUR valuation & Trade Weighted



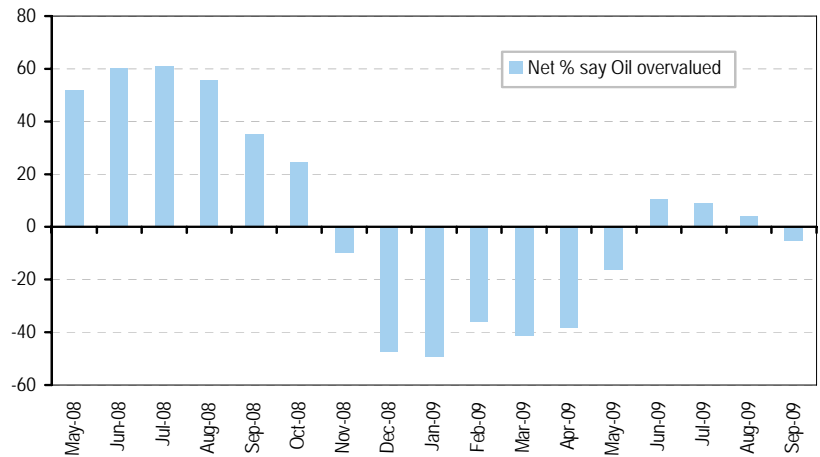
Gold closing in on the \$1000 barrier tips it into overvalued status for investors.

Chart 39: Gold Valuation



Meanwhile a trading range in oil of \$65-75 seems to be fair value for FMS panellists.

Chart 40: Oil Valuation



Global survey demographic data

Table 4: Position / Institution / Approach to Global Equity Strategy

	Sep	Aug	Jul	Jun
Structure of the panel by position				
Chief Investment Officer	32	22	24	23
Asset Allocator / Strategist / Economist	86	74	85	82
Portfolio Manager	99	97	94	105
Other	17	11	18	16
Structure of the panel by expertise				
Global Specialists	137	117	132	137
Regional Specialists With A Global View	97	87	89	89
Total # of Respondents to Global Question	234	204	221	226
Which of the Following Best Describes the Type of Money You are Running?				
Institutional Fund	108	92	103	108
Hedge Fund	31	29	26	29
Retail Fund	63	60	65	59
Other	32	23	27	30
What Do You Estimate to be the Total Current Value of Assets Under Your Direct Control?				
Up to \$250mn	42	45	42	47
Around \$500mn	30	21	28	32
Around \$1bn	31	30	28	27
Around \$2.5bn	27	24	25	25
Around \$5bn	20	25	23	18
Around \$7.5bn	7	5	6	11
Around \$10bn or more	39	28	36	33
No Funds Under Direct Control	37	25	32	32
Total (USDbn)	667	554	635	620
What best describes your investment time horizon at this moment? (Global Respondents)				
3 months or less	74	61	72	69
6 months	76	69	69	79
9 months	19	19	12	13
12 months or more	58	50	60	60
Weighted average	6.8	6.9	6.8	6.9
Don't know	7	5	8	5

Additional information on how the survey works

TNS begins fieldwork on the day the U.S. payroll data is released. Fieldwork continues through the following week and is closed on the following Thursday. TNS sends a link containing the unprocessed results to its survey panellists on Friday. All bona fide institutional fund managers are welcome to participate in the panel.

Important Disclosures

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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