



White swans, revulsion and value

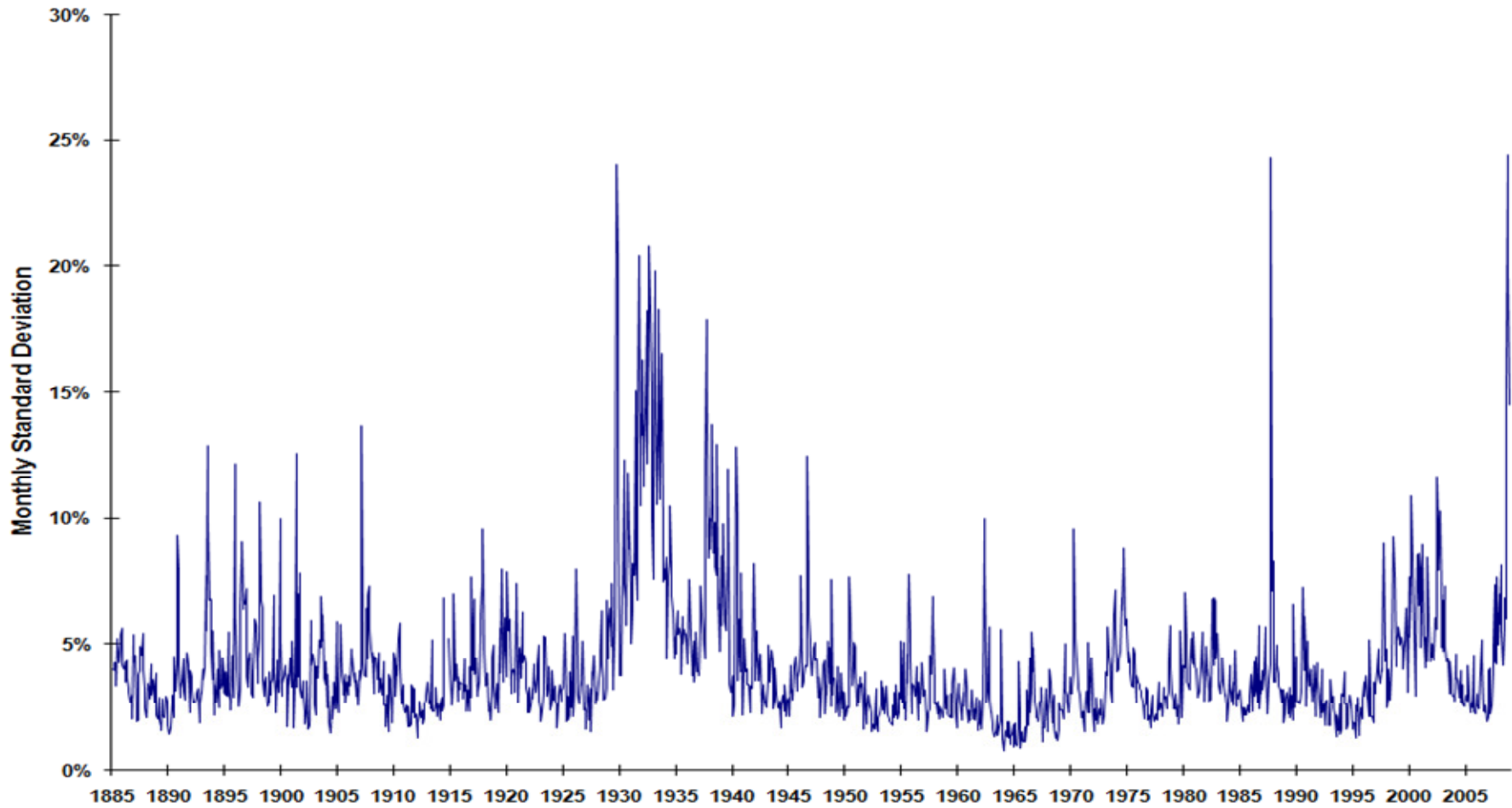
James Montier
Global Strategist

+44 207 762 5872
james.montier@sgcib.com

February 2009



Volatility: not unprecedented nor unpredictable



© G. William Schwert, 2000-2009



Not a Black Swan

Black Swans

- Unpredictable
- Massive Impact
- Ex-post rationalization

Predictable Surprise

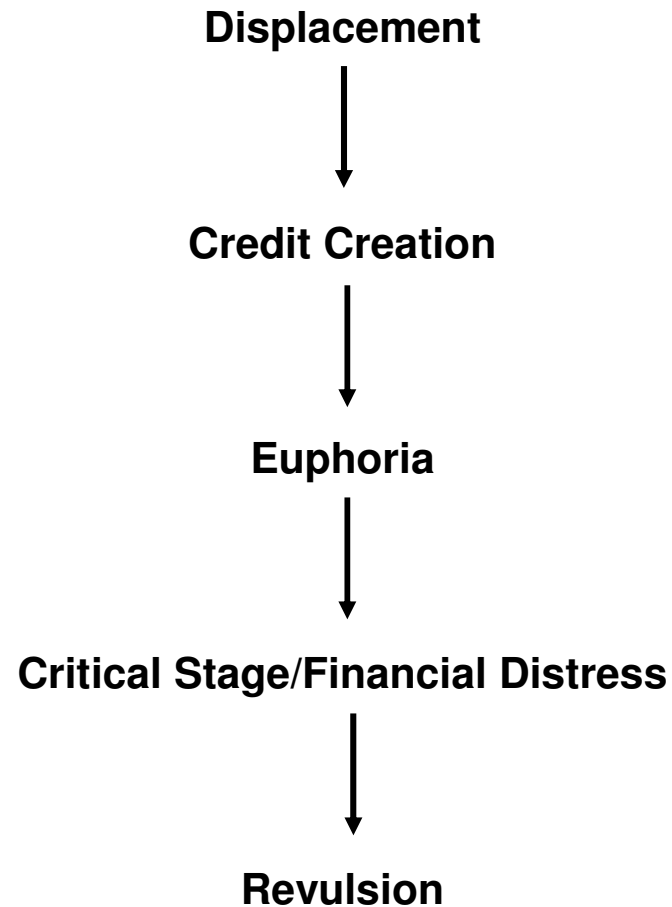
- At least some were aware of the problem
- The problem gets worse over time
- Eventually explodes into crisis

Five impediments to recognising predictable surprises:

- (i) Over-optimism
- (ii) The illusion of control
- (iii) Self-serving bias
- (iv) Myopia
- (v) Change blindness

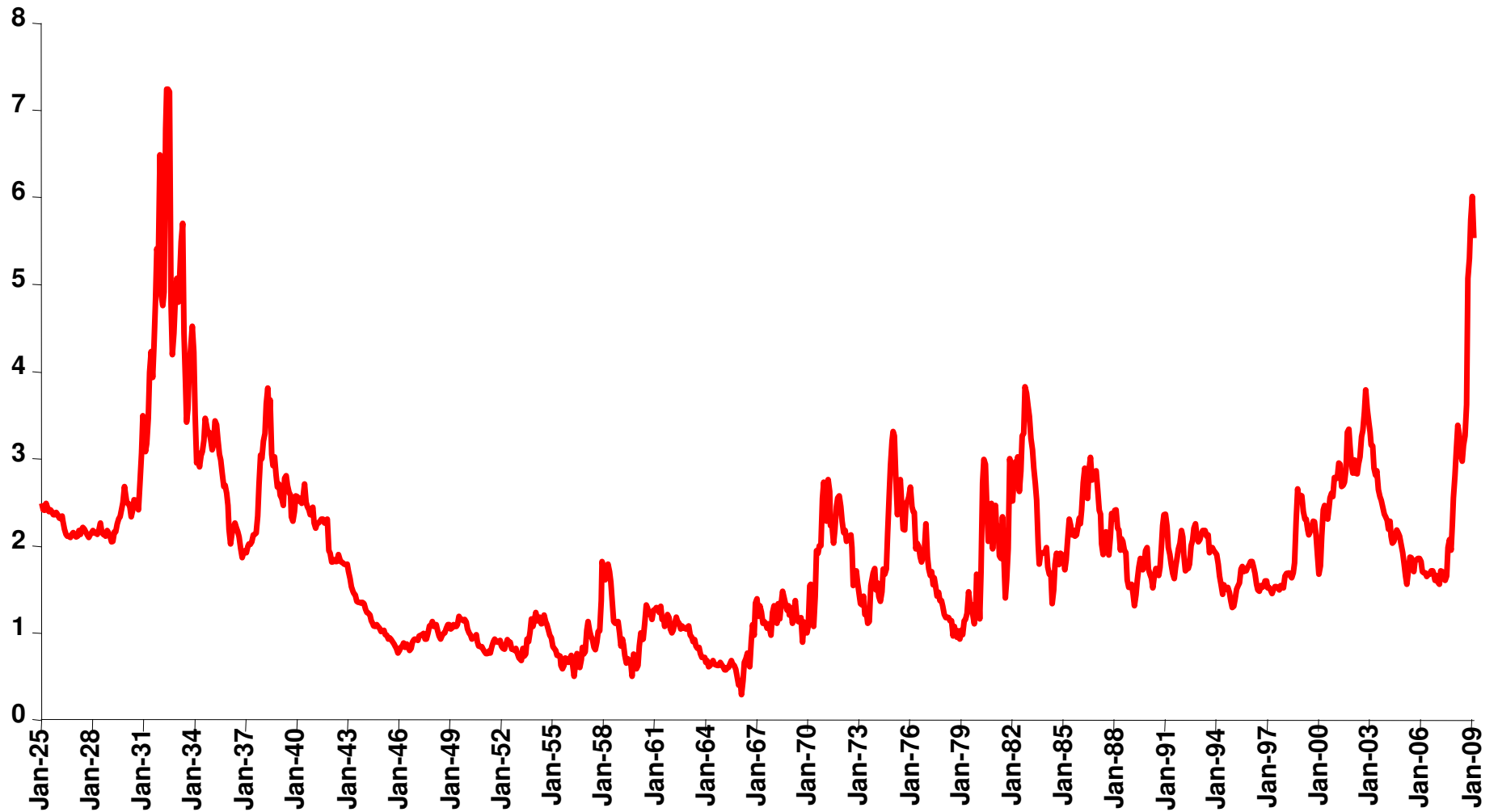


Minsky/Kindleberger framework for bubbles



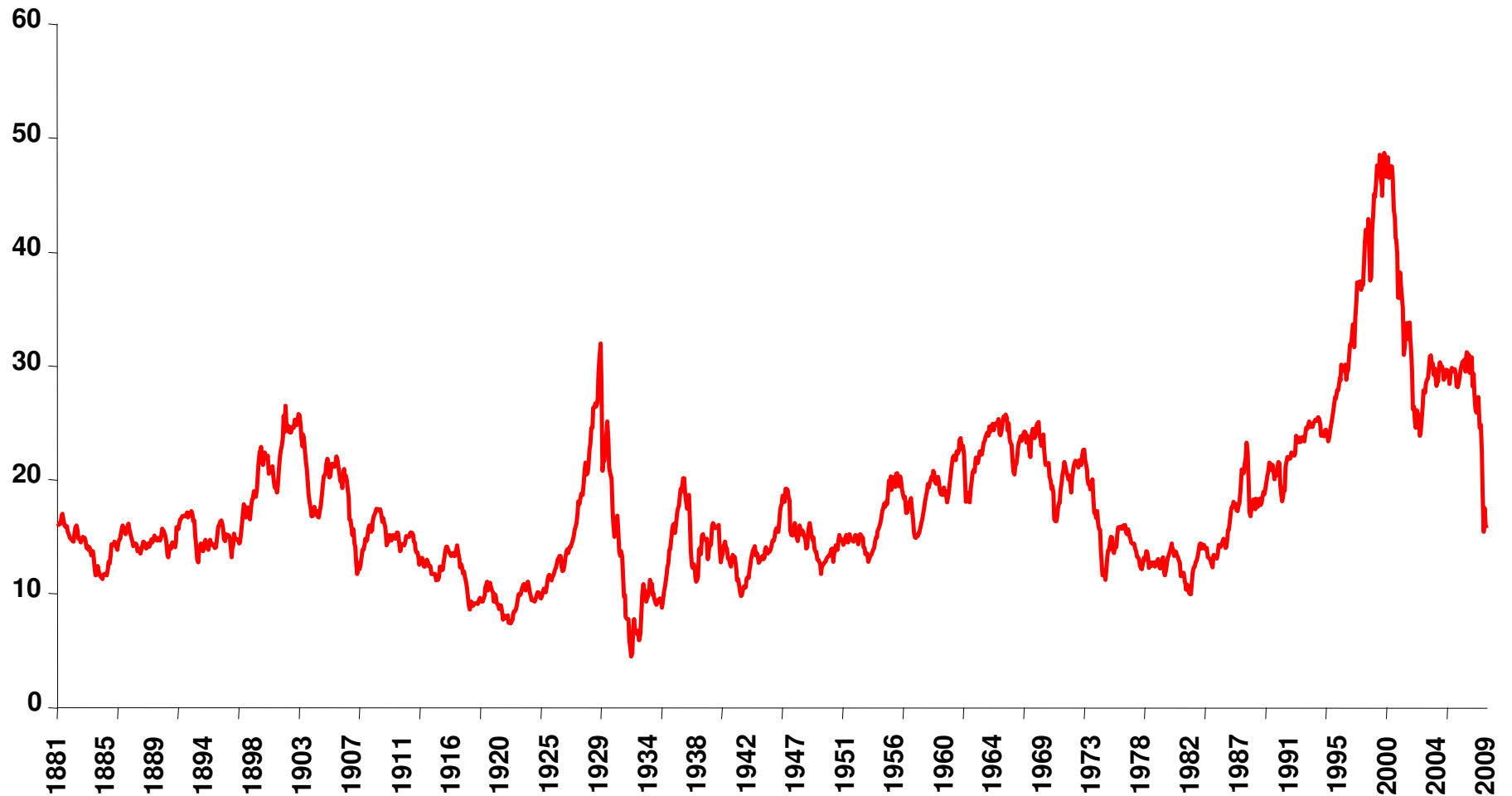


Debt is closer to revulsion (BAA spread)





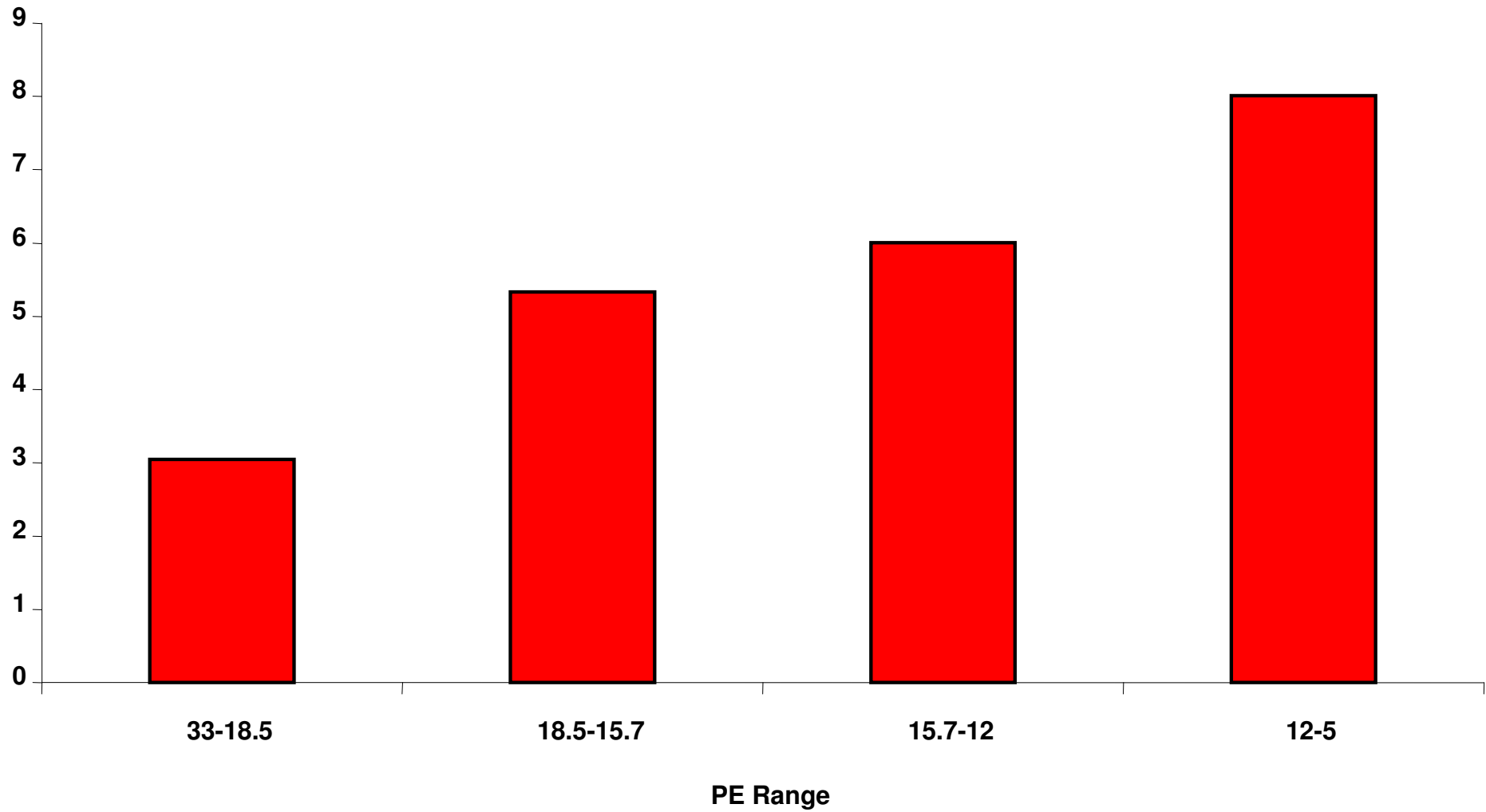
Valuation - Graham and Dodd PE (US)



Source: SG Equity Research

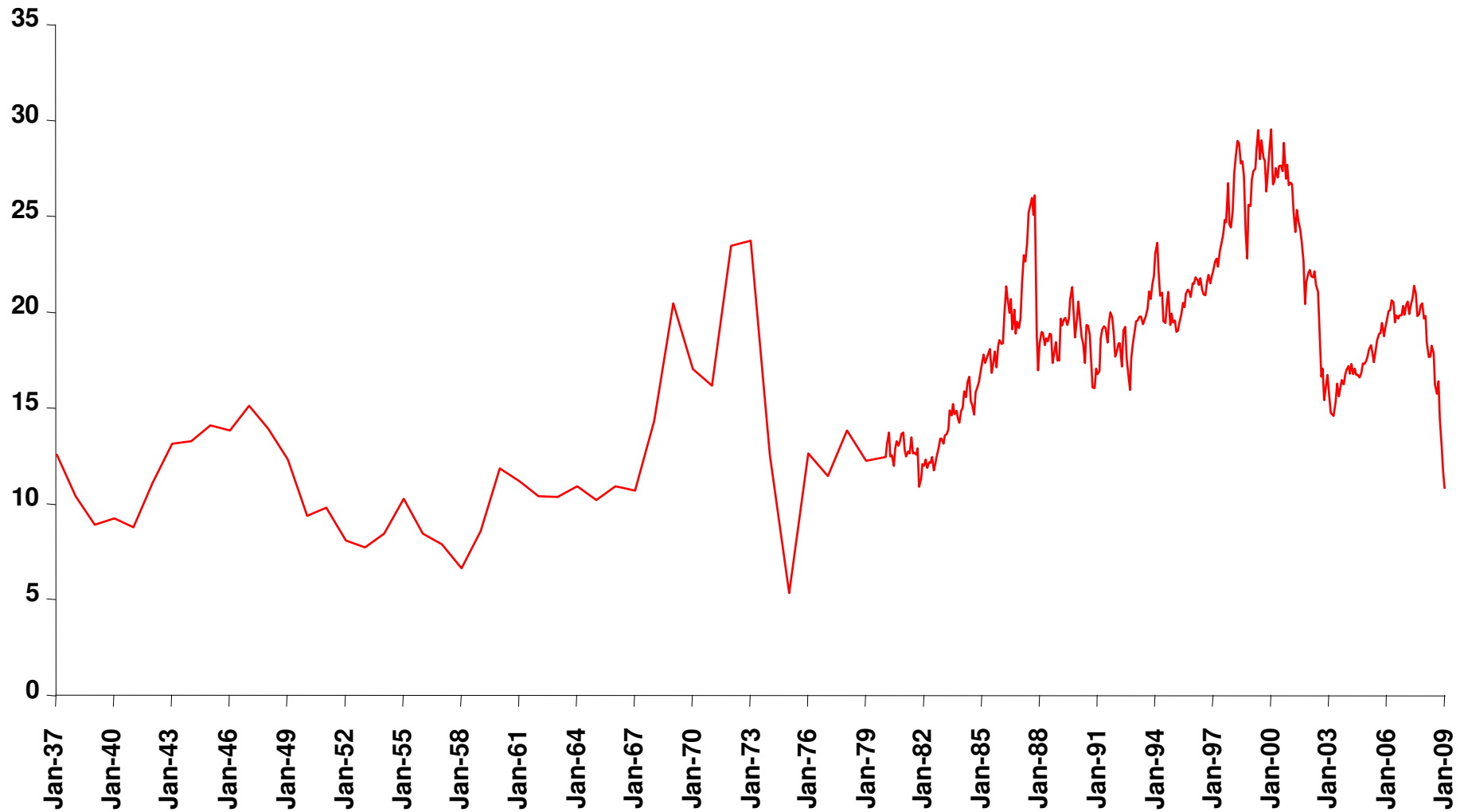


Valuations determine long run returns (% p.a. real)





UK Graham and Dodd PE



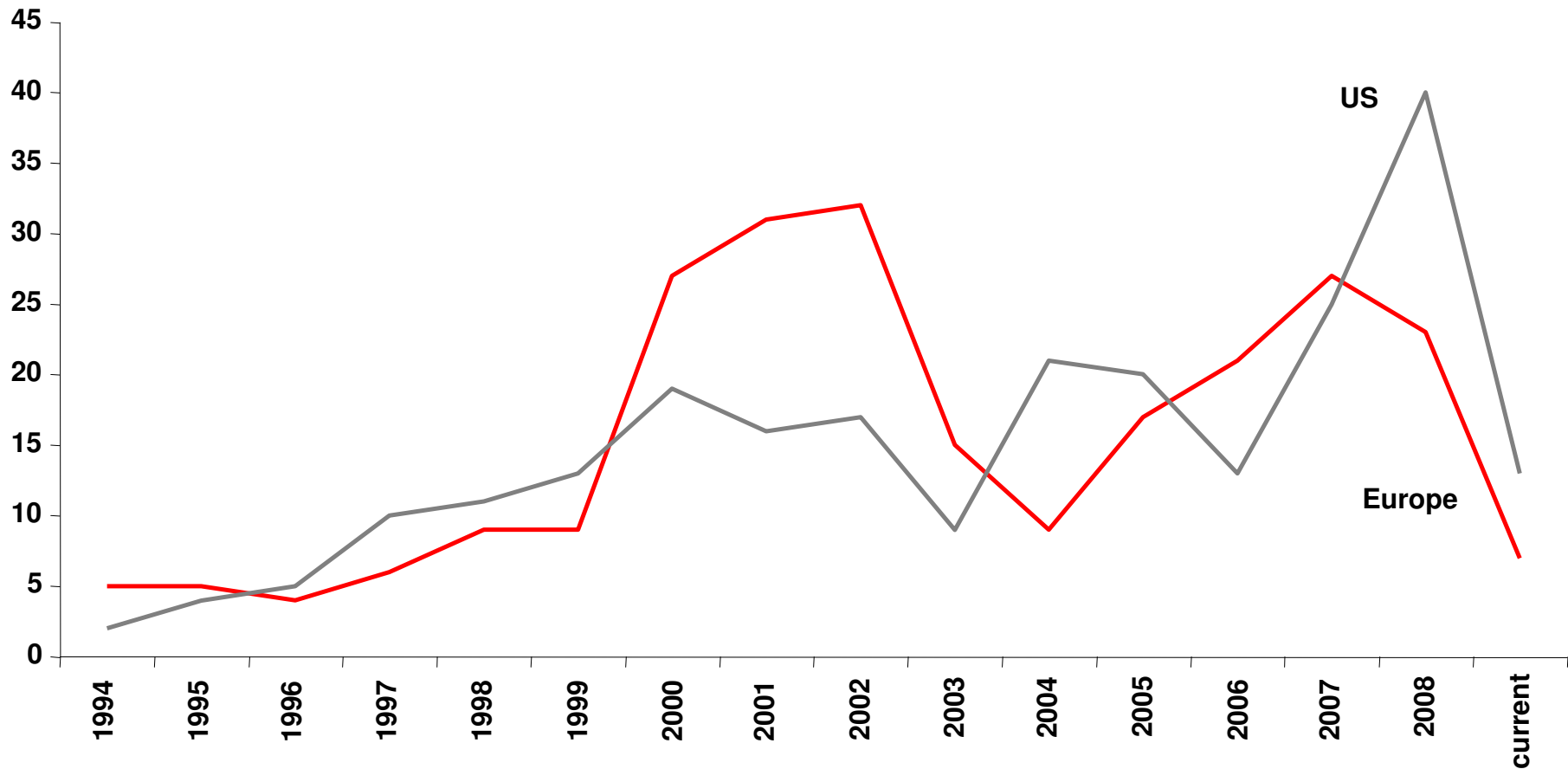


What would Ben think? (% passing)

| Criteria | US | Europe | UK | Japan | Asia |
|-------------------------------------|----------|----------|----------|-----------|-----------|
| EY>(2*AAA) | 46 | 59 | 58 | 82 | 66 |
| PE < 40% of Peak PE | 8 | 10 | 15 | 4 | 10 |
| DY>2/3 of AAA | 37 | 72 | 69 | 82 | 60 |
| Price < 2/3 TBV | 1 | 3 | 9 | 15 | 10 |
| Price < 2/3 NCA | 0 | 0.4 | 3 | 0 | 0 |
| Total debt < 2/3 of TBV | 38 | 38 | 43 | 70 | 72 |
| Current ratio >2 | 27 | 16 | 20 | 24 | 26 |
| Total debt <= 2*NCA | 20 | 17 | 24 | 35 | 26 |
| CAGR >=7% over 10y | 54 | 48 | 29 | 55 | 41 |
| 2 or fewer earnings declines of -5% | 5 | 8 | 14 | 6 | 9 |
| 1,3,6 and G&D PE <16 | 3 | 9 | 8 | 22 | 17 |

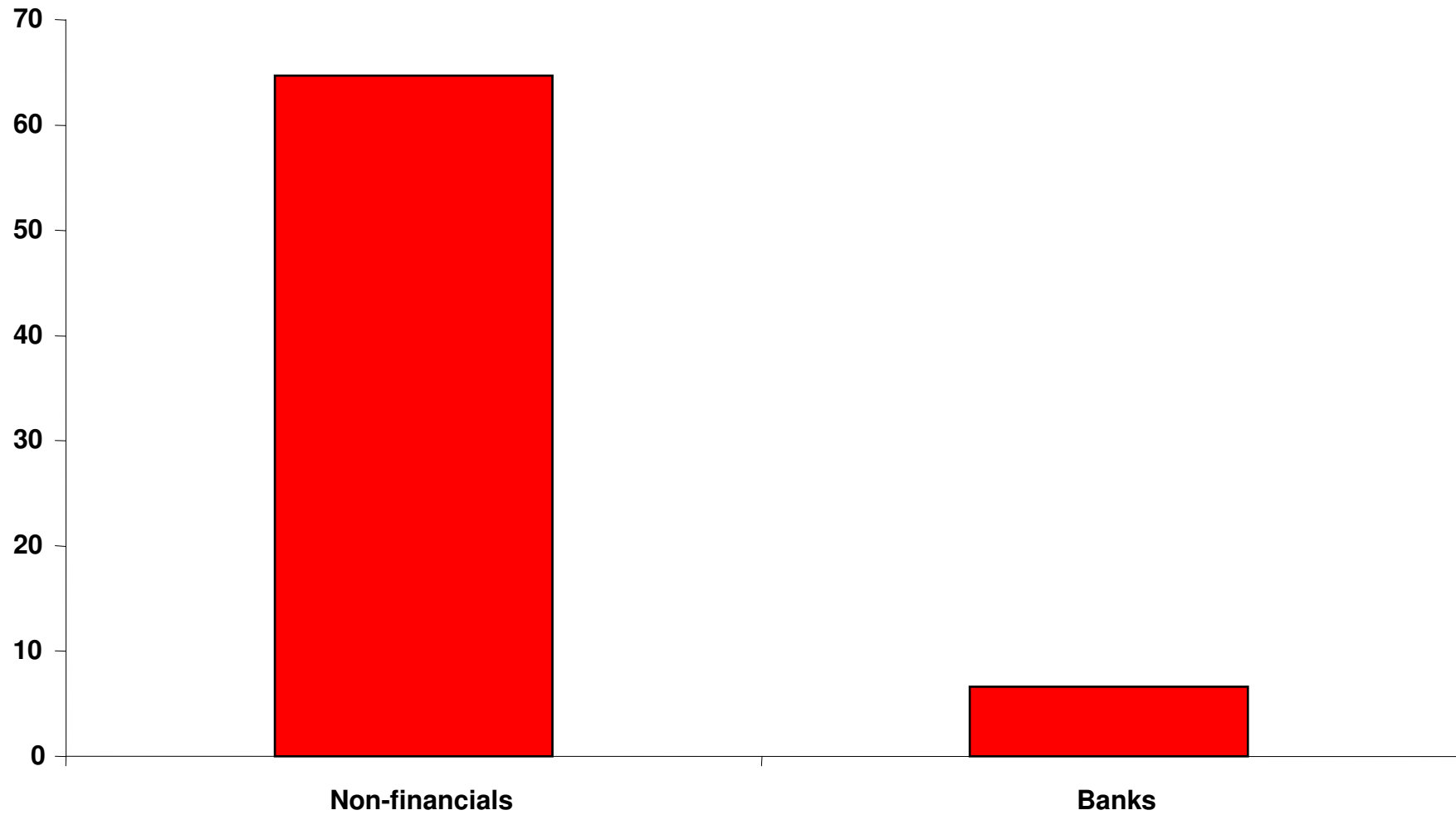


Number of Stocks passing our Short criteria (P/S>2, C score =5)



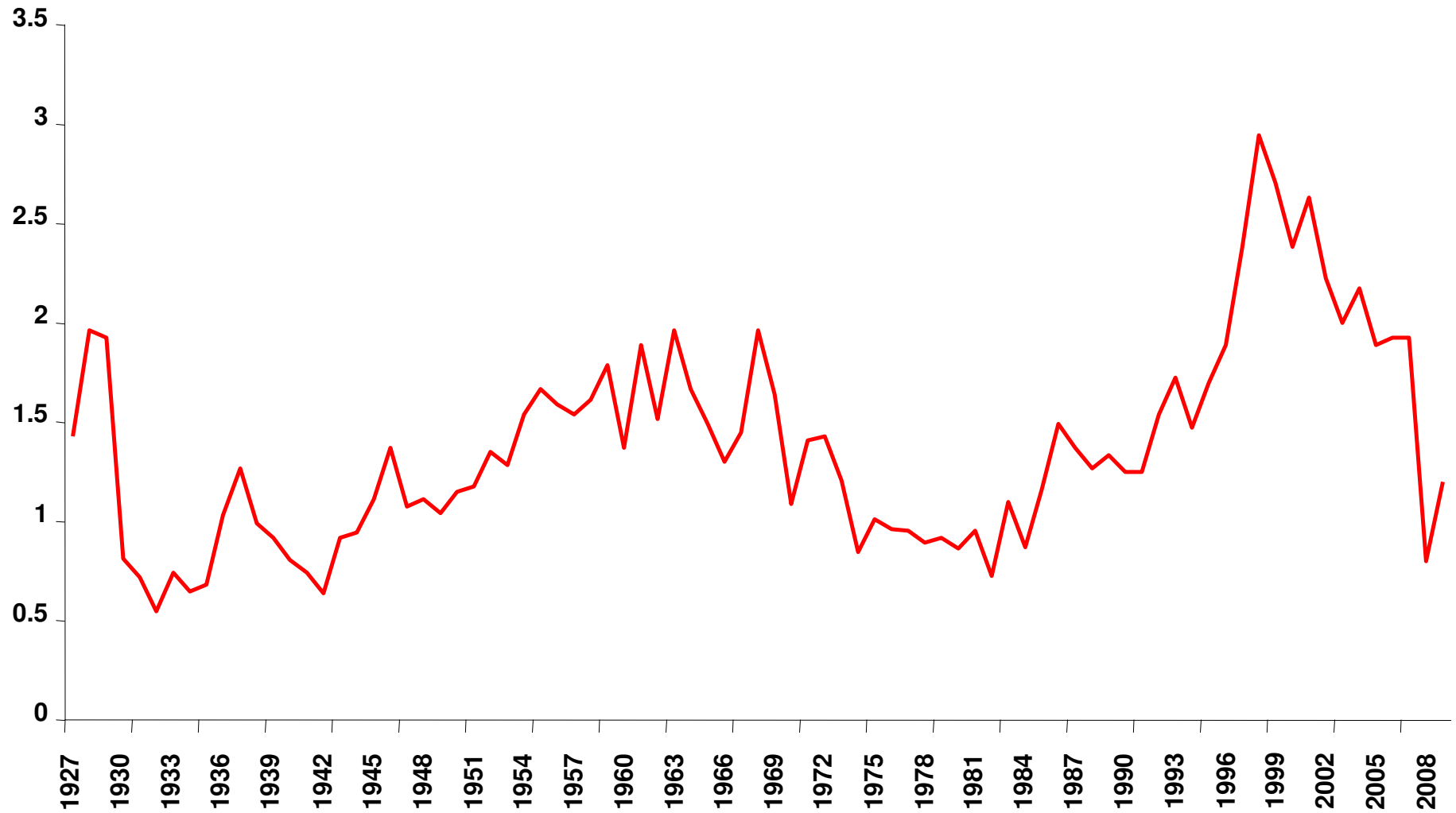


Shareholder's equity as % of total liabilities



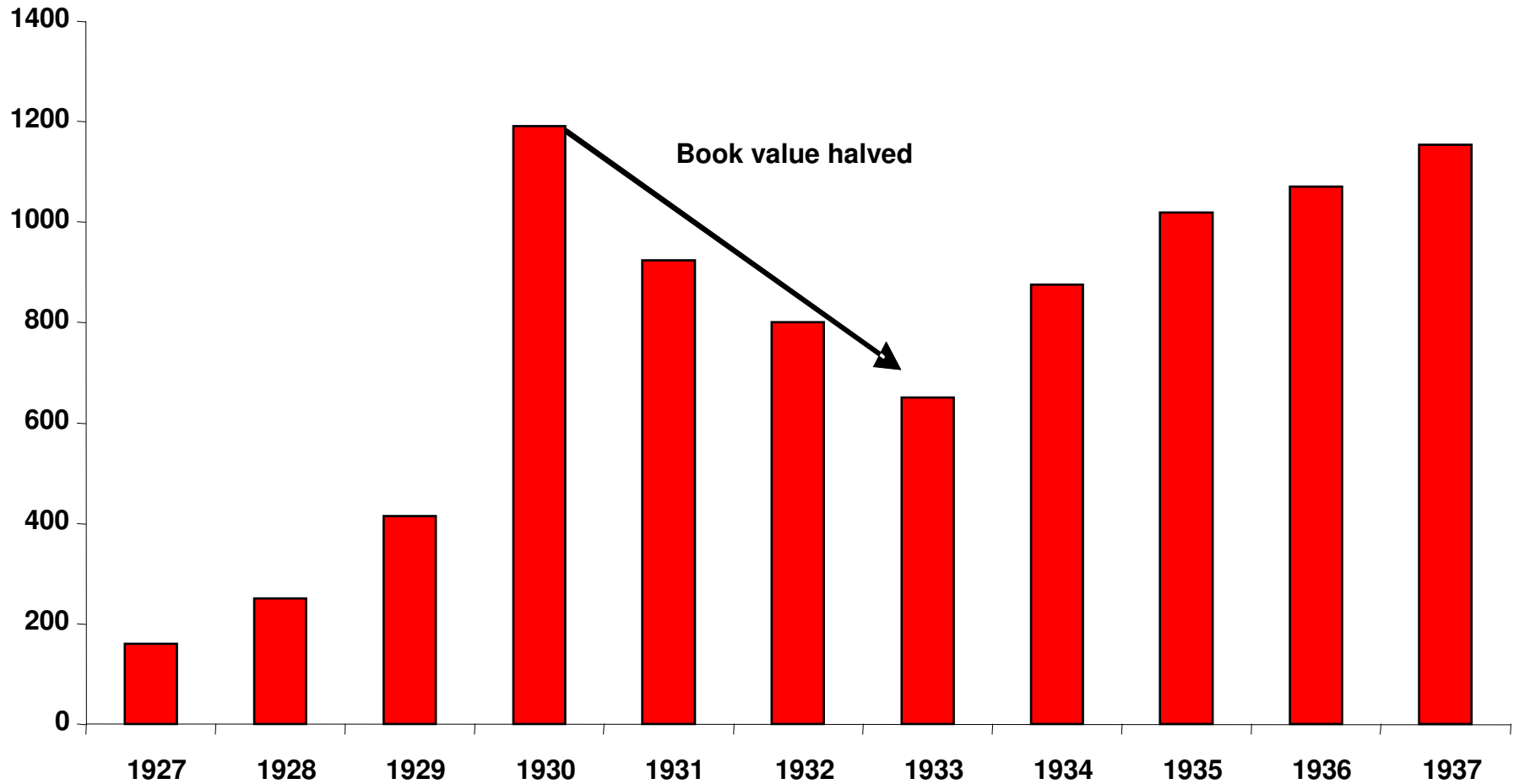


Long-term US financials price to book



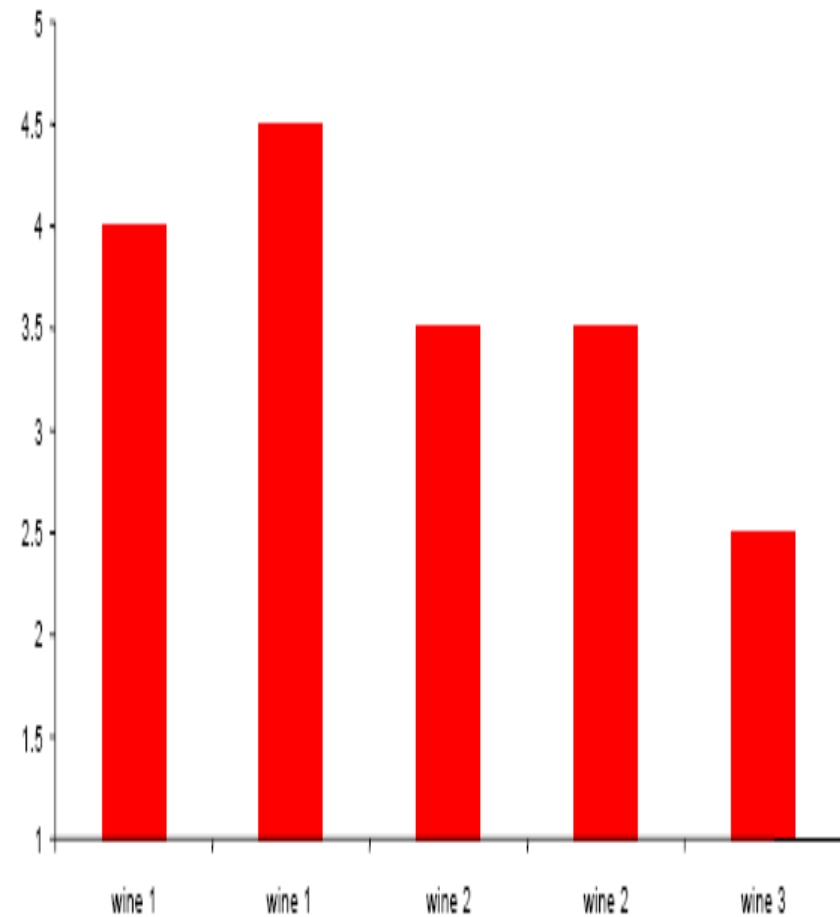
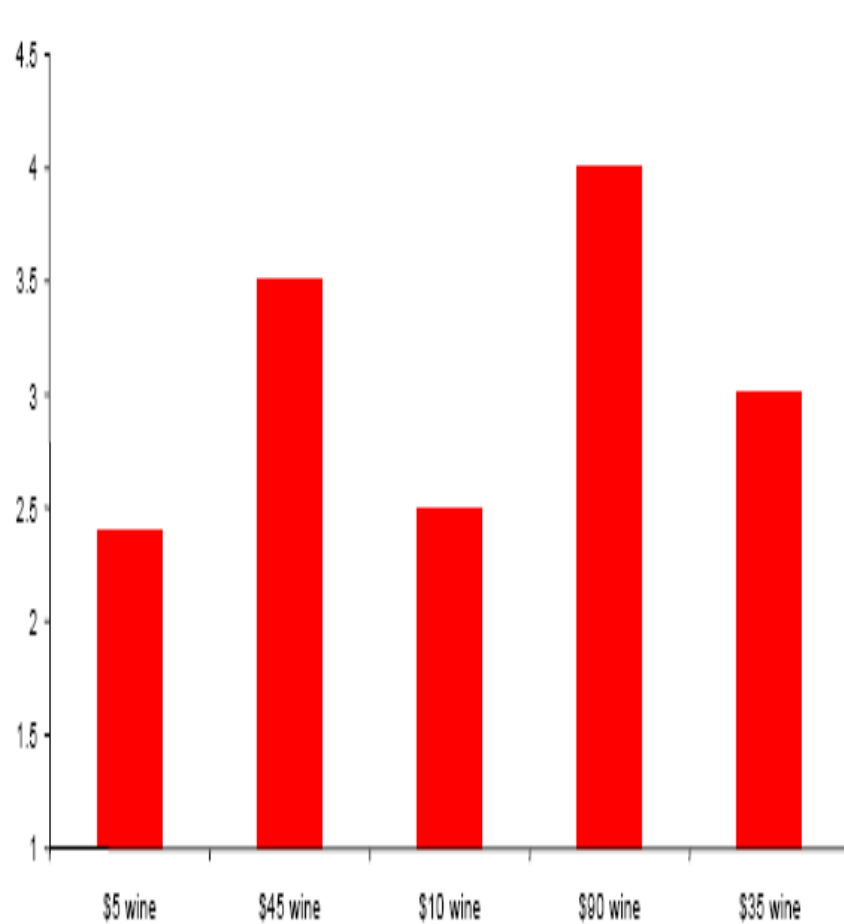


Beware book value



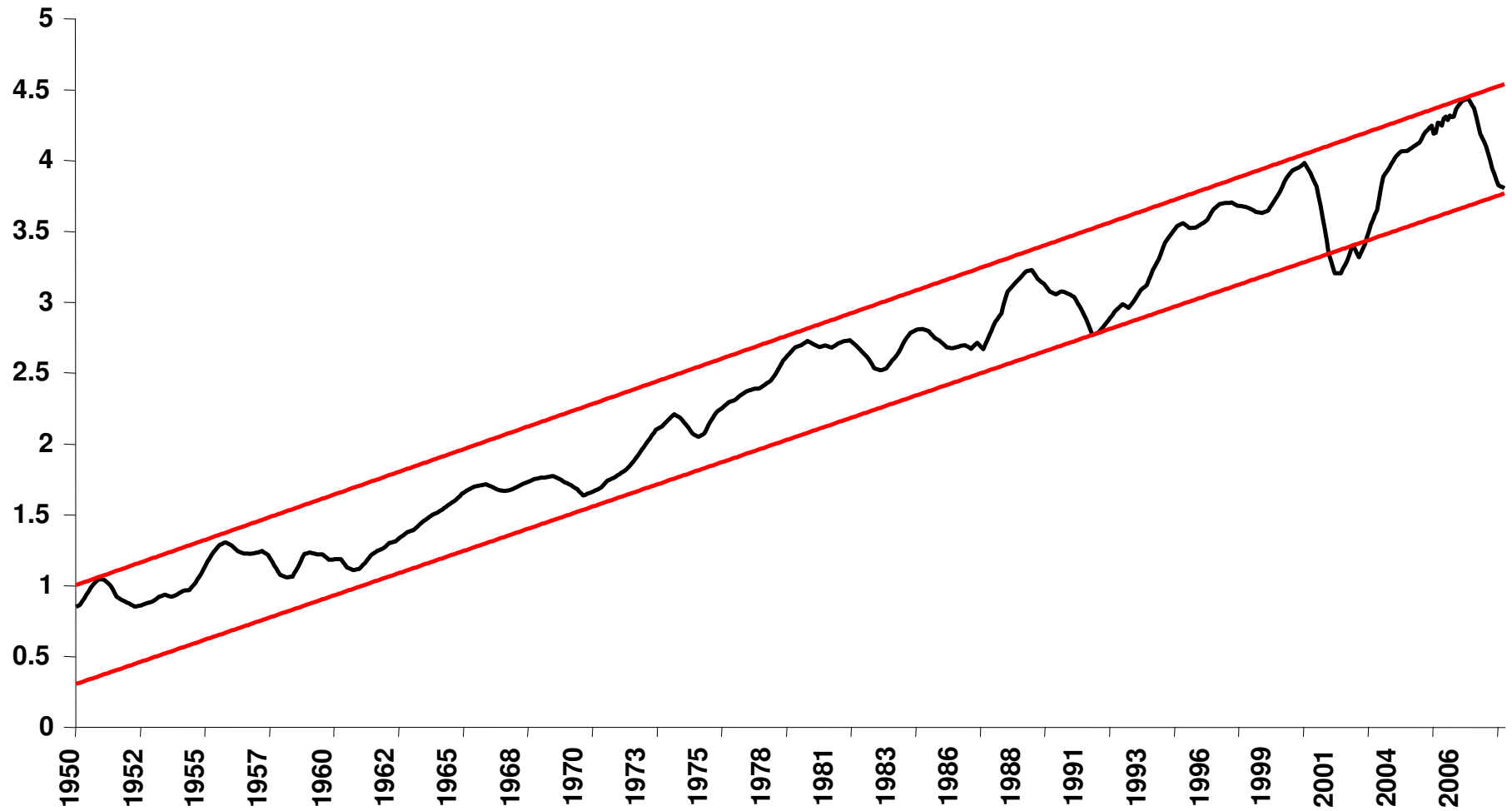


A bias against value? Does expensive wine taste better?



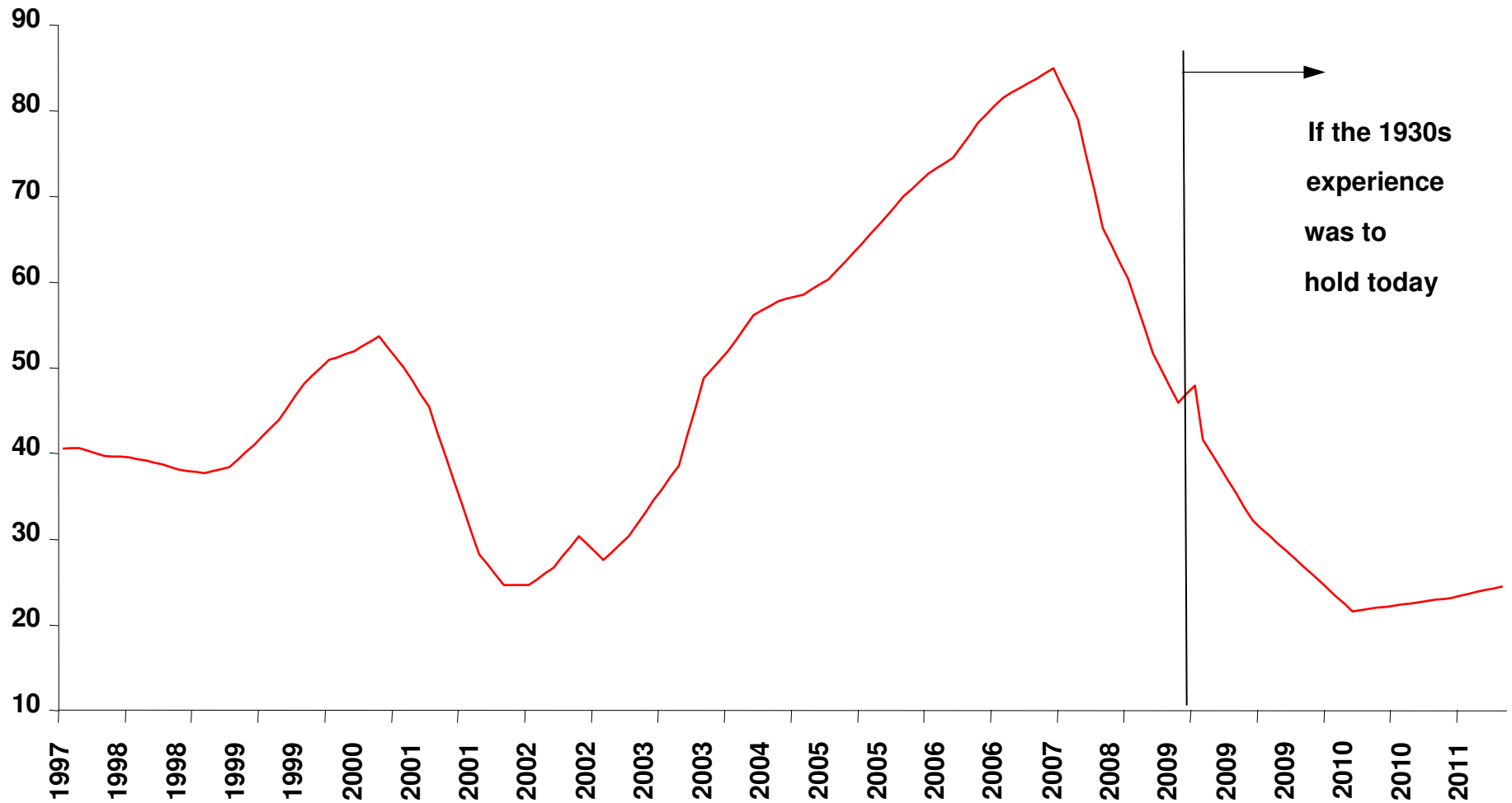


The earnings cycle – S&P500





What if the 1930's repeated? (S&P500)





Why buy value? Protection against error and poor outcomes

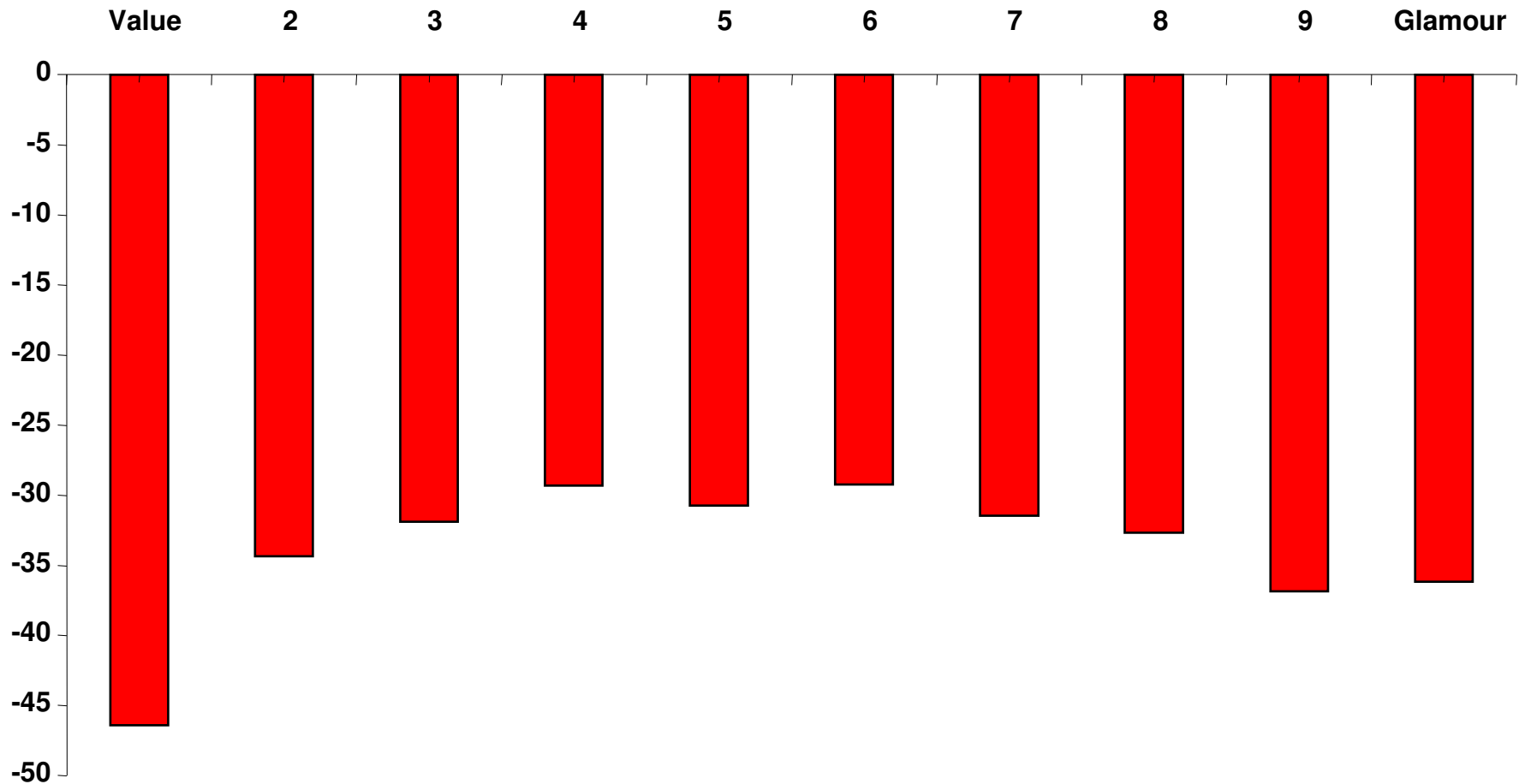
Returns split by earnings performance (Developed mkts 1985-2007) % p.a.

| | Highest Growth | 2 | 3 | 4 | Lowest Growth |
|---------|----------------|------|------|------|---------------|
| Value | 19.8 | 21.6 | 17.7 | 15.9 | 11.9 |
| 2 | 20.6 | 18.0 | 13.7 | 11.0 | 10.9 |
| 3 | 17.8 | 14.0 | 11.6 | 9.87 | 8.10 |
| 4 | 15.7 | 10.5 | 8.55 | 6.67 | 6.12 |
| Glamour | 7.90 | 5.04 | 4.42 | 2.77 | 2.18 |

Source: SG Equity Research

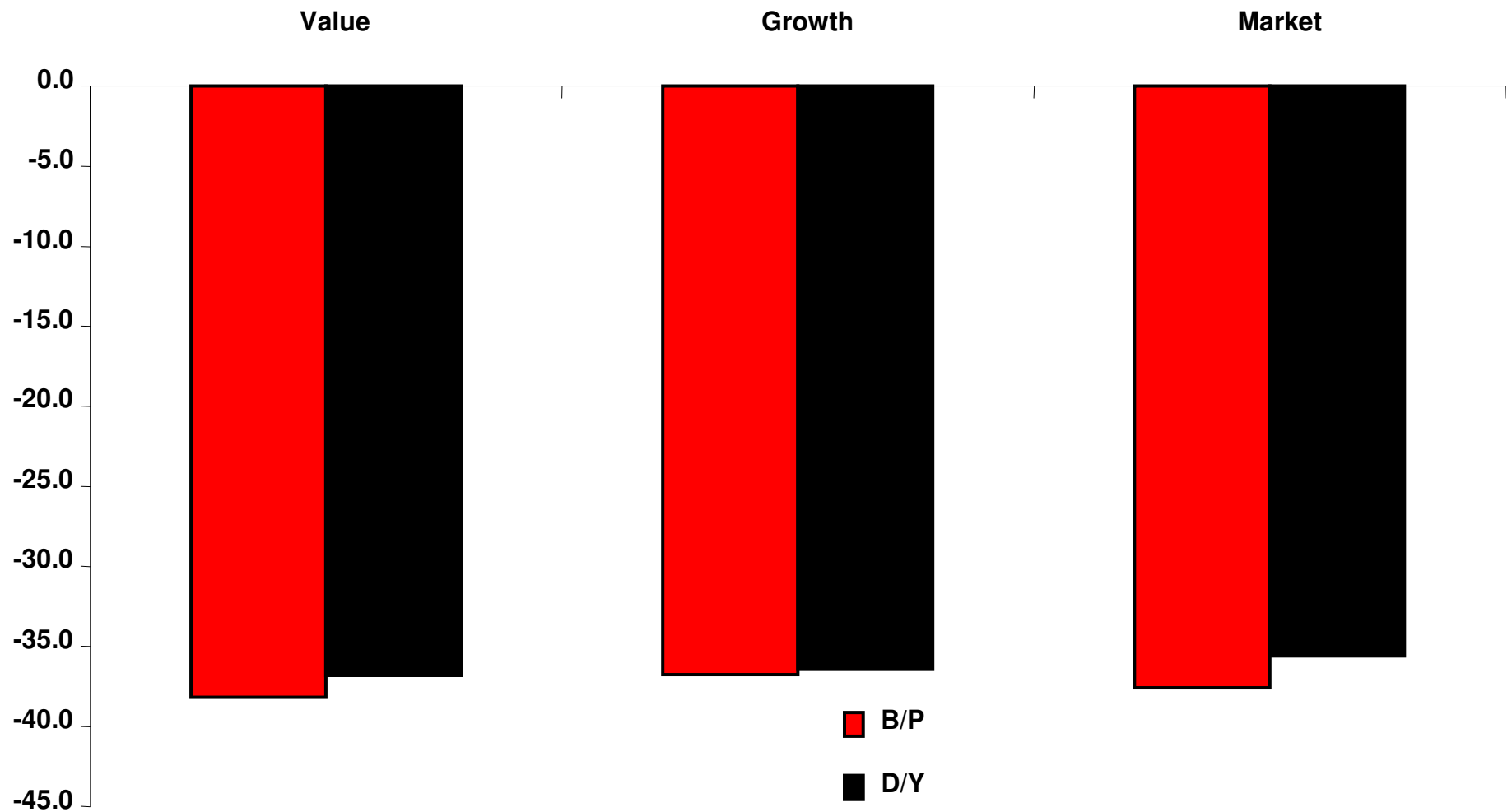


Indiscriminate selling – Performance across G&D PE deciles (%) 2008



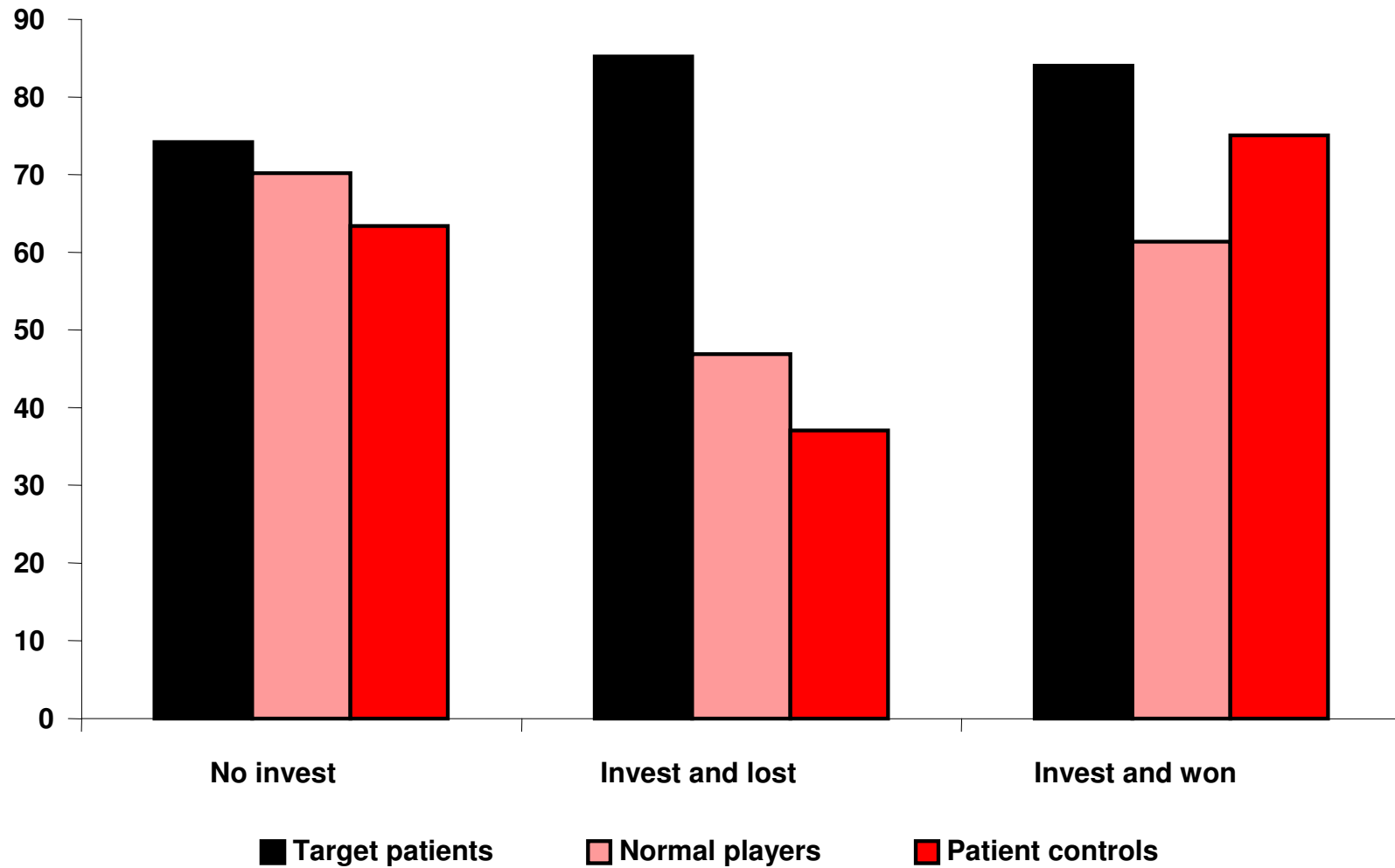


Value in the Great Depression (% p.a.)



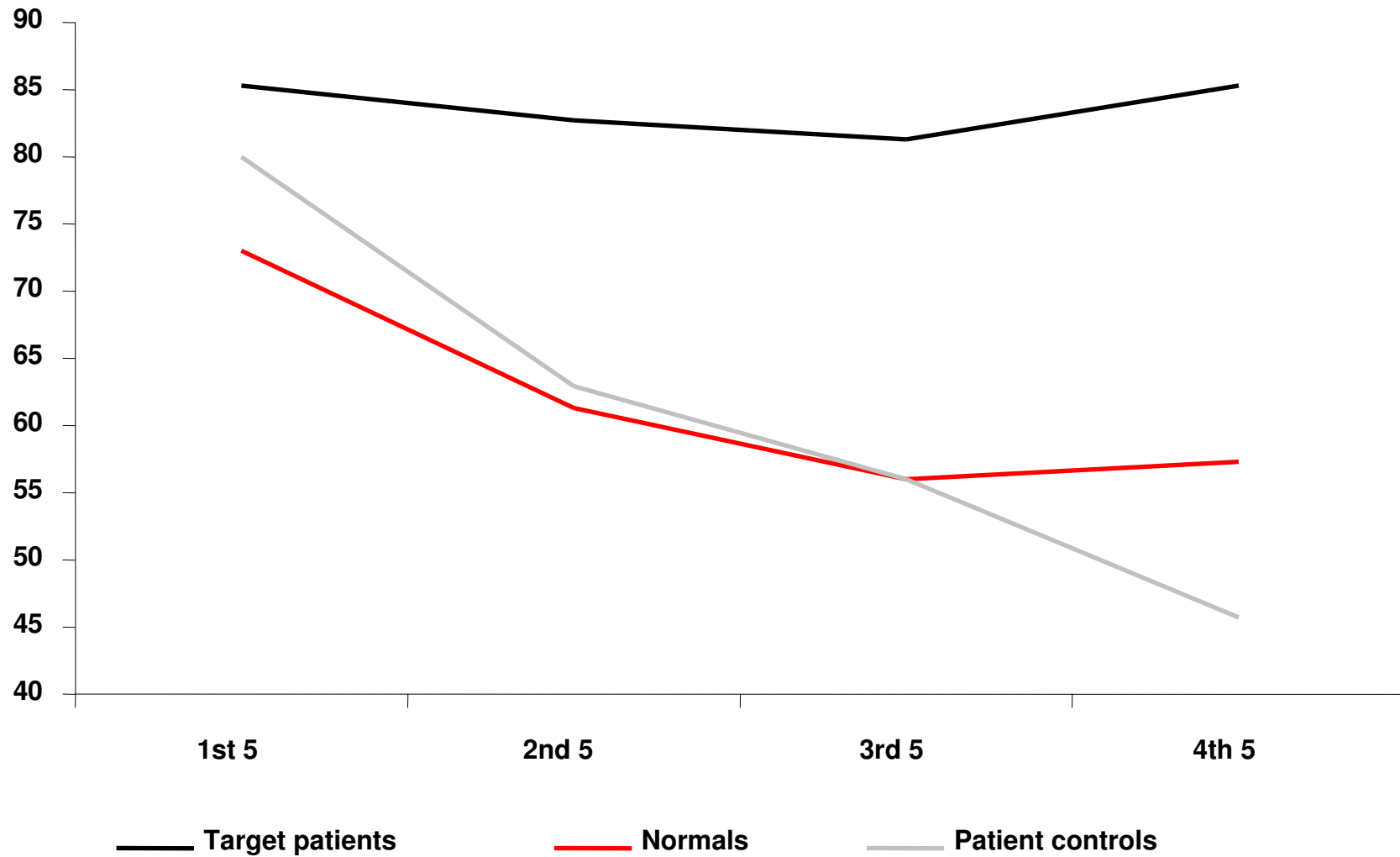


The dark side of emotion: the psychology of bear markets



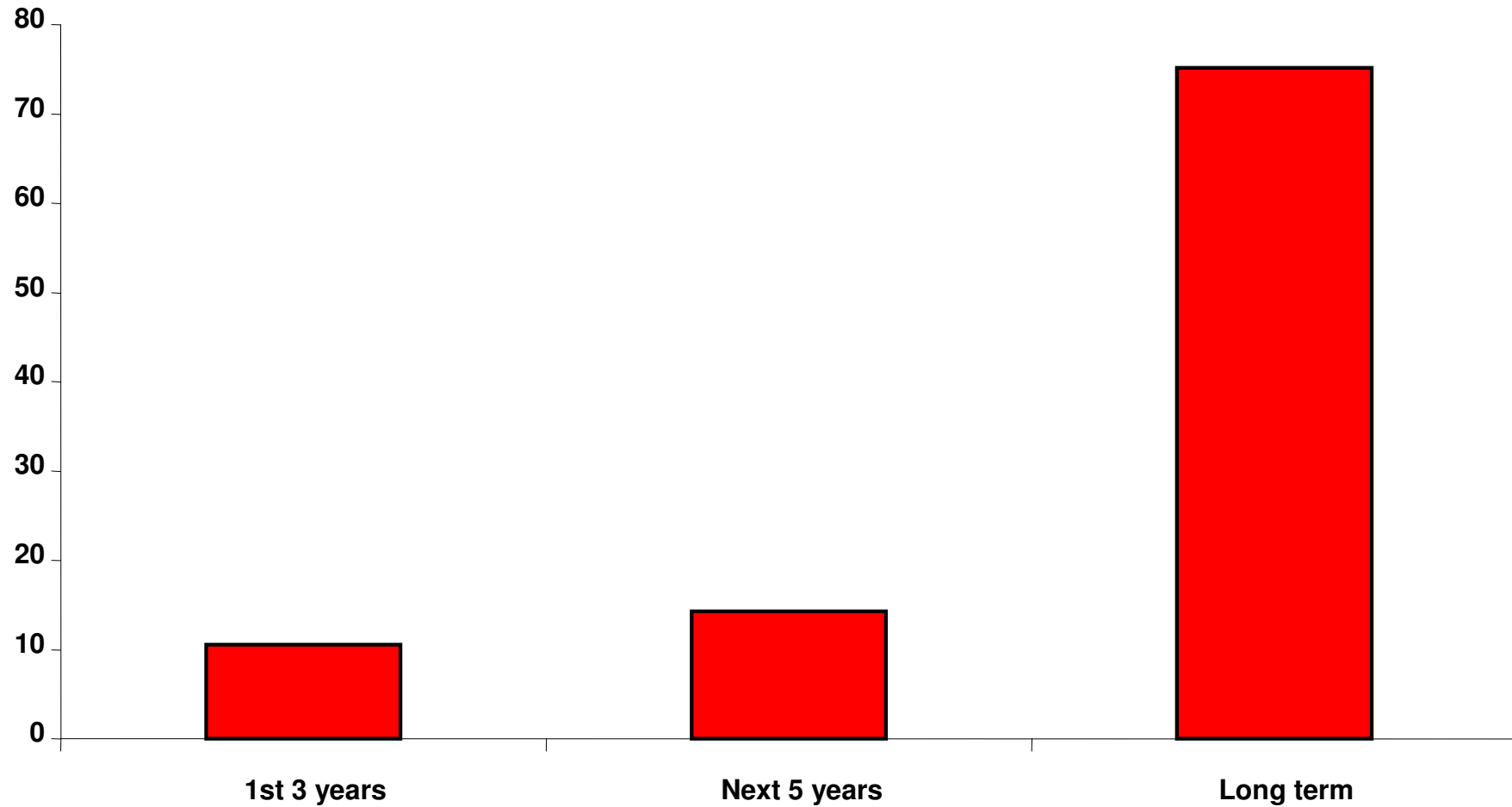


No sign of learning: the longer it lasts, the worse we get



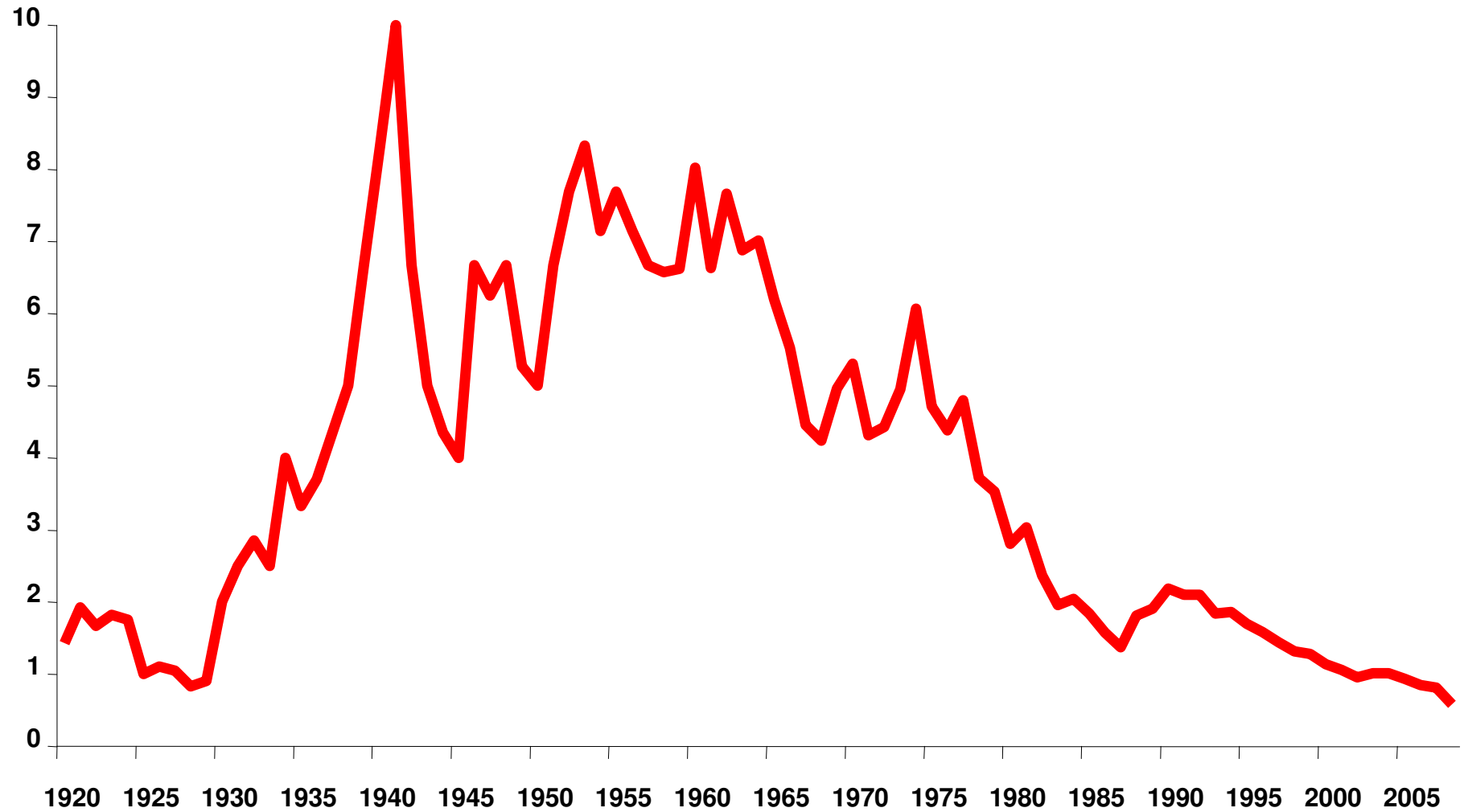


Equities are a long duration asset – contribution to value from... (%)





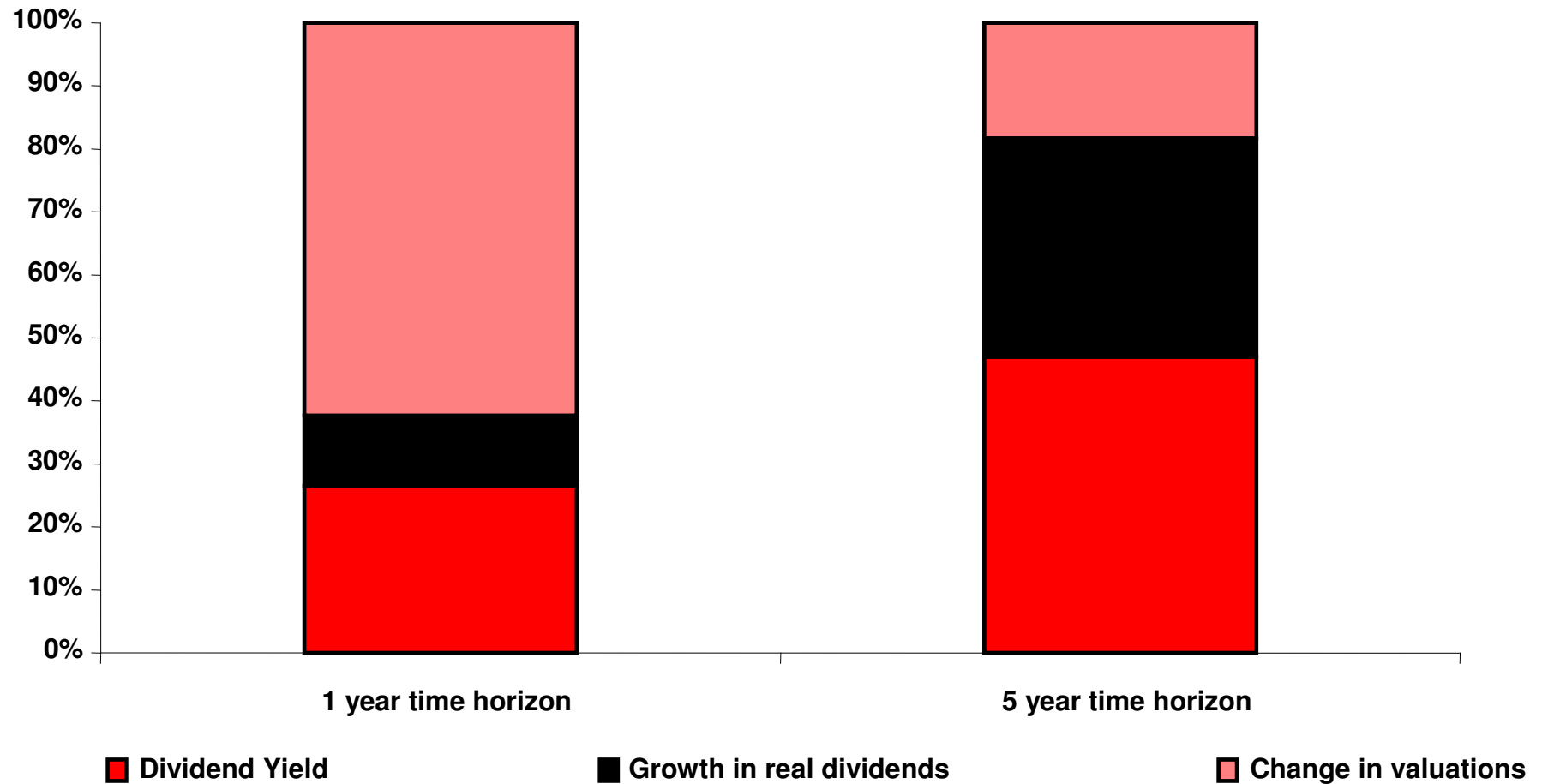
ADHD and stock holding periods



Source: NYSE

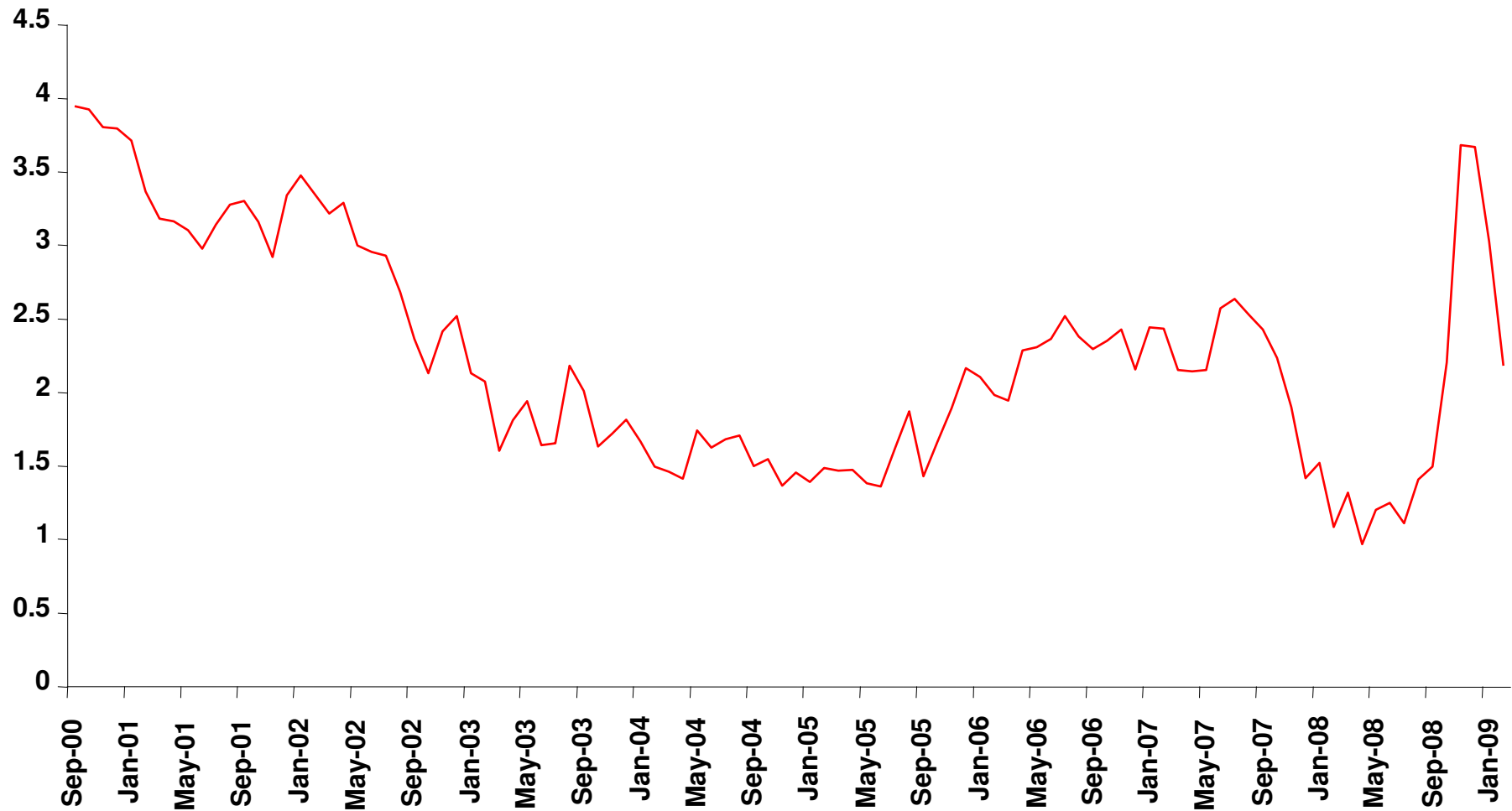


Contributions to total real returns





Sources of cheap insurance (Index linked yields TIPS)





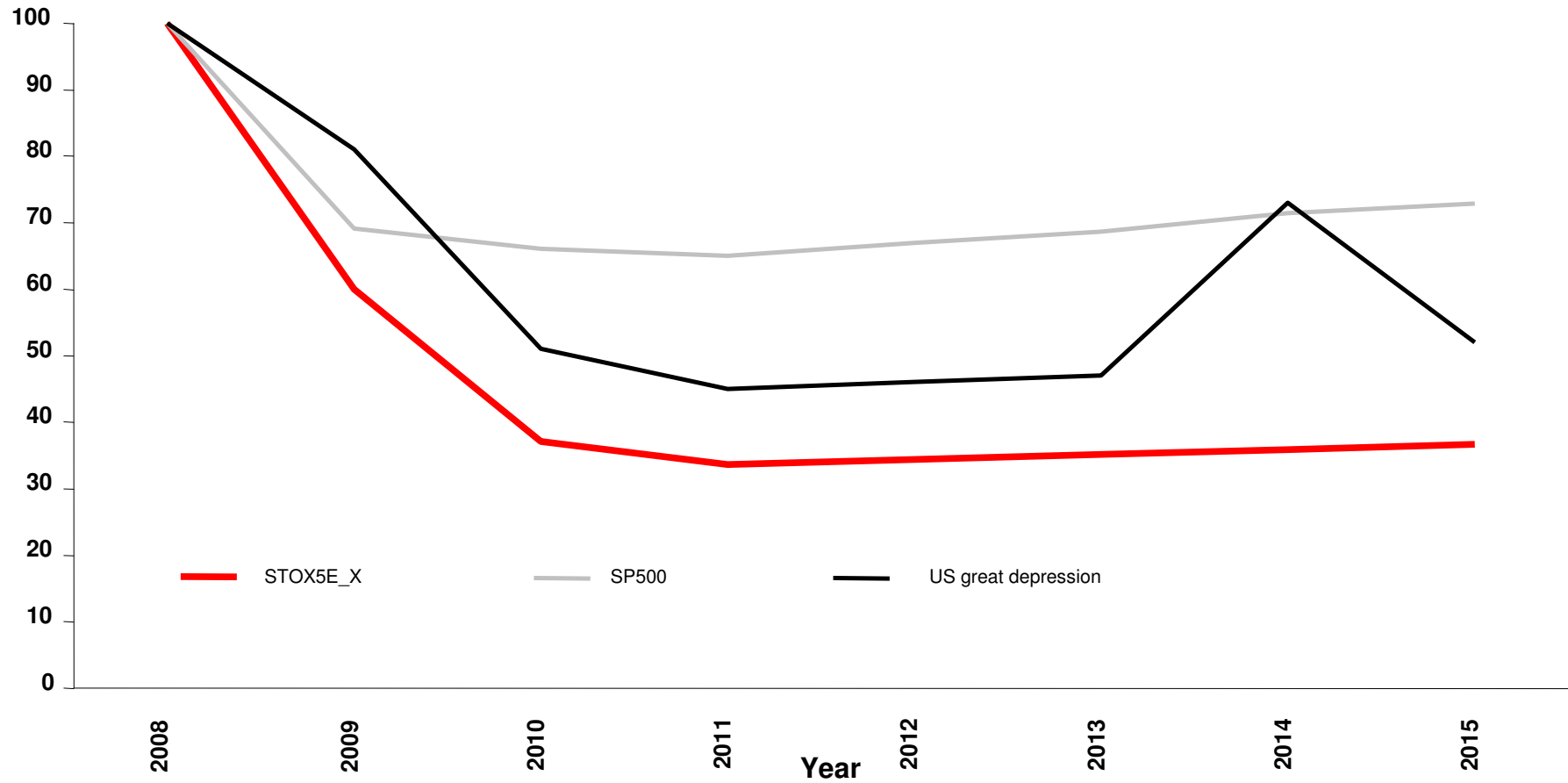
 **Gold**





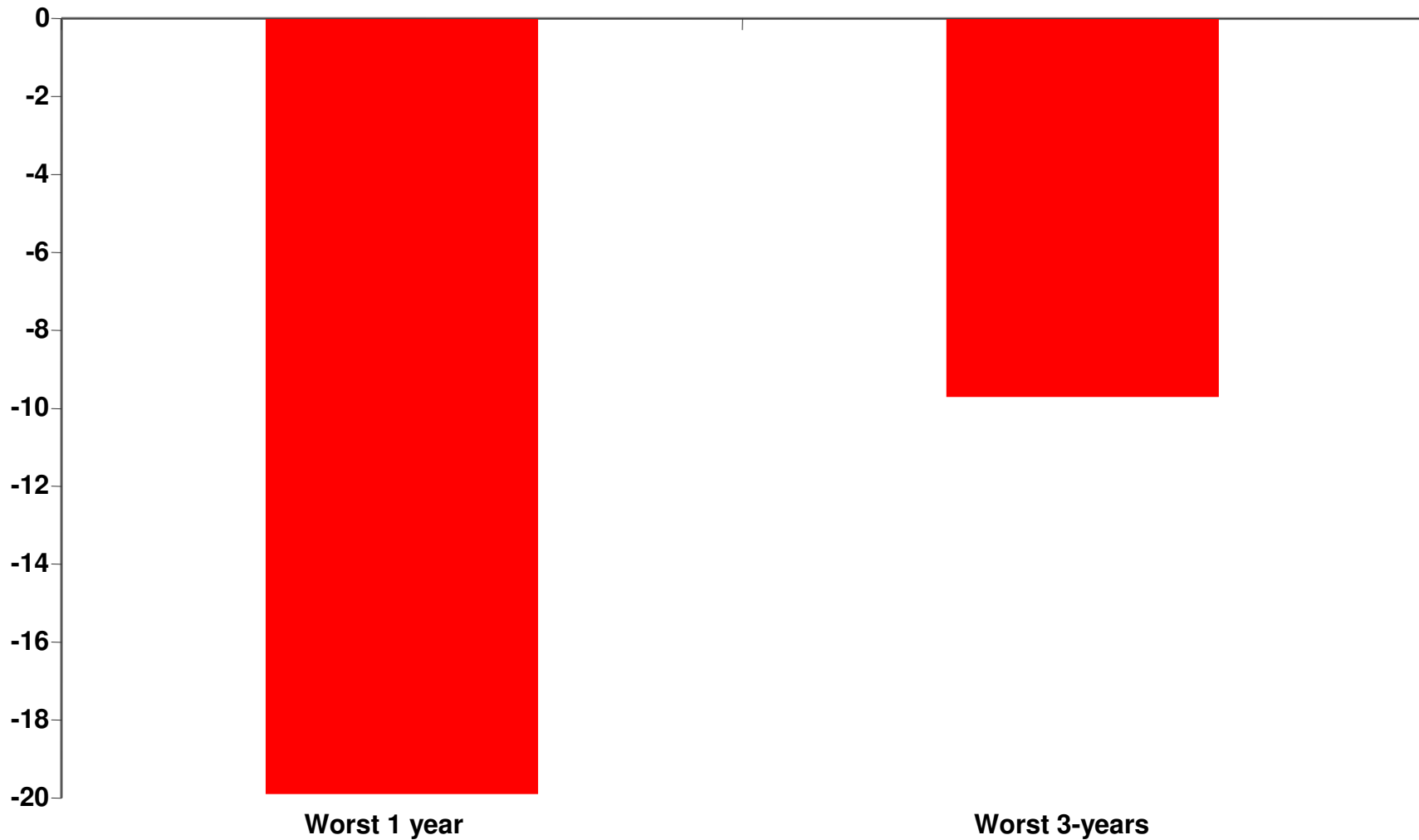
Dividend swaps

World dividends discounts- 2008 = basis 100



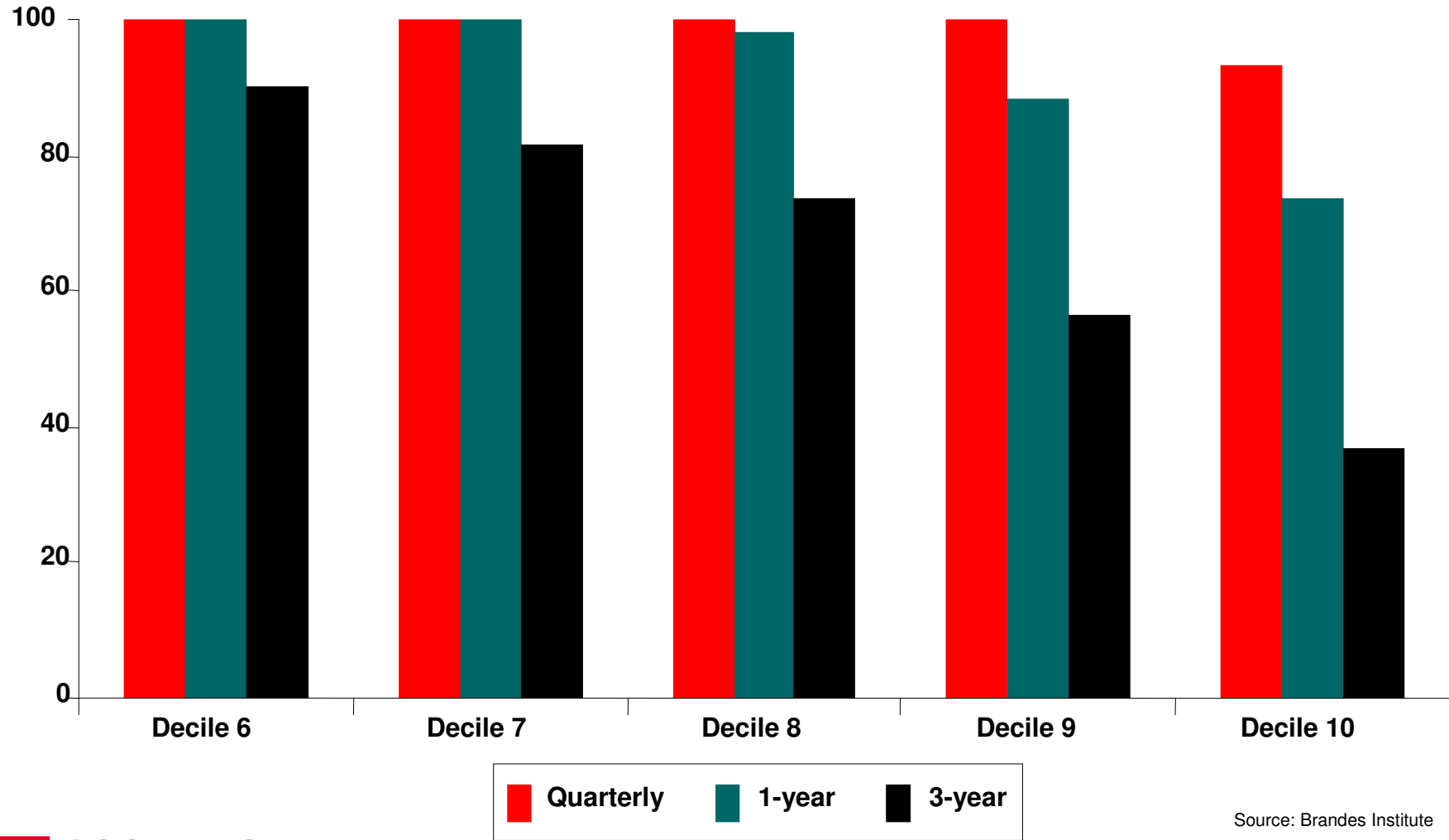


■ ■ Top decile fund managers – Performance in...

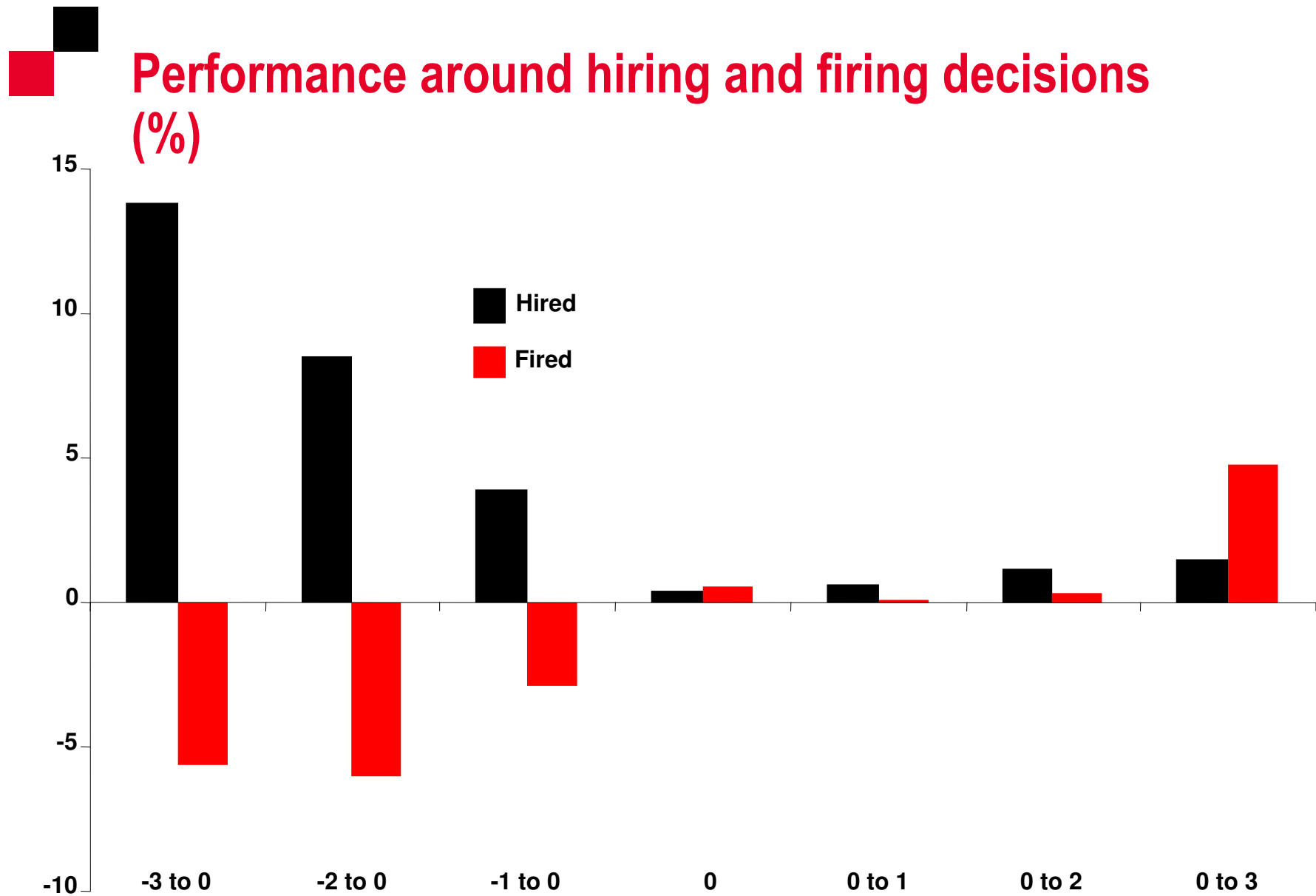




Percentage of long-term top performers in lower performance deciles



Source: Brandes Institute





IMPORTANT DISCLAIMER

IMPORTANT DISCLAIMER: The information herein is not intended to be an offer to buy or sell, or a solicitation of an offer to buy or sell, any securities and including any expression of opinion, has been obtained from or is based upon sources believed to be reliable but is not guaranteed as to accuracy or completeness although Société Générale ("SG") believe it to be clear, fair and not misleading. SG, and their affiliated companies in the SG Group, may from time to time deal in, profit from the trading of, hold or act as market-makers or act as advisers, brokers or bankers in relation to the securities, or derivatives thereof, of persons, firms or entities mentioned in this document or be represented on the board of such persons, firms or entities. Employees of SG, and their affiliated companies in the SG Group, or individuals connected to them, other than the authors of this report, may from time to time have a position in or be holding any of the investments or related investments mentioned in this document. Each author of this report is not permitted to trade in or hold any of the investments or related investments which are the subject of this document. SG and their affiliated companies in the SG Group are under no obligation to disclose or take account of this document when advising or dealing with or for their customers. The views of SG reflected in this document may change without notice. To the maximum extent possible at law, SG does not accept any liability whatsoever arising from the use of the material or information contained herein. This research document is not intended for use by or targeted at private customers. Should a private customer obtain a copy of this report they should not base their investment decisions solely on the basis of this document but must seek independent financial advice.

Important notice: The circumstances in which materials provided by SG Fixed & Forex Research, SG Commodity Research, SG Convertible Research, SG Technical Research and SG Equity Derivatives Research have been produced are such (for example because of reporting or remuneration structures or the physical location of the author of the material) that it is not appropriate to characterise it as independent investment research as referred to in European MIF directive and that it should be treated as a marketing material even if it contains a research recommendation (« recommandation d'investissement à caractère promotionnel »). However, it must be made clear that all publications issued by SG will be clear, fair, and not misleading.

Analyst Certification: Each author of this research report hereby certifies that (i) the views expressed in the research report accurately reflect his or her personal views about any and all of the subject securities or issuers and (ii) no part of his or her compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed in this report.

Notice to French Investors: This publication is issued in France by or through Société Générale ("SG") which is regulated by the AMF (Autorité des Marchés Financiers).

Notice to UK investors: This publication is issued in the United Kingdom by or through Société Générale ("SG") London Branch which is authorised and regulated by the Financial Services Authority ("FSA") for the conduct of its UK business.

Notice To US Investors: This report is intended only for major US institutional investors pursuant to SEC Rule 15a-6. Any US person wishing to discuss this report or effect transactions in any security discussed herein should do so with or through SG Americas Securities, LLC ("SGAS") 1221 Avenue of the Americas, New York, NY 10020. (212)-278-6000. THIS RESEARCH REPORT IS PRODUCED BY SOCIETE GENERALE AND NOT SGAS.

Notice to Japanese Investors: This report is distributed in Japan by Société Générale Securities (North Pacific) Ltd., Tokyo Branch, which is regulated by the Financial Services Agency of Japan. The products mentioned in this report may not be eligible for sale in Japan and they may not be suitable for all types of investors.

Notice to Australian Investors: Société Générale Australia Branch (ABN 71 092 516 286) (SG) takes responsibility for publishing this document. SG holds an AFSL no. 236651 issued under the Corporations Act 2001 (Cth) ("Act"). The information contained in this newsletter is only directed to recipients who are wholesale clients as defined under the Act.

US THIRD PARTY FOREIGN AFFILIATE RESEARCH DISCLOSURES:

The subject company of this research report currently is, or was during the 12-month period preceding the date of distribution of this report, a client of SG or its affiliates.

SG or its affiliates has received compensation for investment banking services from the subject company of this research report in the past 12 months.

SG or its affiliates expects to receive or intends to seek compensation for investment banking services from the subject company of this research report in the next 3 months.

SG or its affiliates acts as a market maker or liquidity provider in the equities securities that are subject of this research report.

IMPORTANT DISCLOSURES: Please refer to our website: <http://www.sgresearch.socgen.com>

<http://www.sgcib.com>. Copyright: The Société Générale Group 2008. All rights reserved.