

CHAPTER 12 Macroeconomic and Industry Analysis

Framework of Analysis

- Fundamental Analysis
- Approach to Fundamental Analysis
 - Domestic and global economic analysis
 - Industry analysis
 - Company analysis
- Why use the top-down approach

12.1 THE GLOBAL ECONOMY

Global Economic Considerations

- Performance in countries and regions is highly variable
- Political risk
- Exchange rate risk
 - Sales
 - Profits
 - Stock returns

Table 12.1 Economic Performance, 2006

Economic performance, 2006	Stock Market Return (%)		Growth in GDP (%)
	In Local Currency	In U.S. Dollars	
Brazil	32.9	45.2	3.2
Britain	12.5	27.3	2.7
Canada	12.7	12.5	2.5
China	130.6	138.4	10.4
France	19.0	33.1	1.9
Germany	23.7	38.4	2.8
India	49.1	51.3	9.2
Japan	6.9	5.7	1.6
Mexico	49.5	47.8	4.6
Russia	56.3	70.7	6.5
Singapore	29.4	40.4	5.9
Switzerland	17.6	26.7	2.4
Thailand	20.9	22.5	4.7
U.S.	13.5	13.5	3.0
Venezuela	162.6	99.0	10.2

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Figure 12.1 Change in Real Exchange Rate: Dollar Versus Major Currencies, 1999-2006

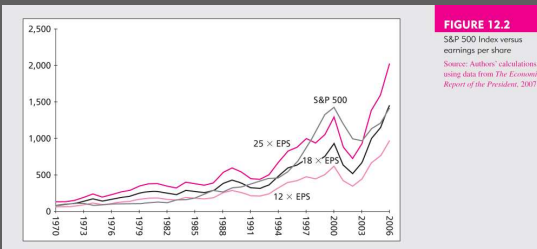


12.2 THE DOMESTIC MACROECONOMY

Key Economic Variables

- Gross domestic product
- Employment
- Inflation
- Interest rates
- Budget Deficits
- Consumer sentiment

Figure 12.2 S&P 500 Versus EPS Estimate

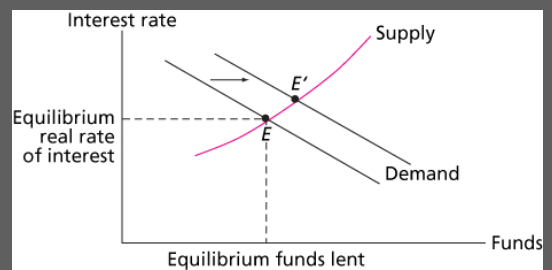


12.3 INTEREST RATES

Factors Determining the Level of Interest Rates

- Supply of funds from savers
- Demand for funds from businesses
- Government's net supply and/or demand for funds
- Expected rate of inflation

Figure 12.3 Determination of the Equilibrium Real Rate of Interest



12.4 DEMAND AND SUPPLY SHOCKS

Demand Shocks

- Demand
 - An event that affects the demand for goods and services
 - Reduction in tax rates
 - Increases in the money supply
 - Increases in government spending
 - Increases in foreign export demand

Supply Shocks

- Supply
 - An event that influences production capacity and costs
 - Changes in the price of imported oil
 - Freezes
 - Floods
 - Droughts
 - Changes in the wage rates

12.5 FEDERAL GOVERNMENT POLICY

Fiscal Policy

- Government spending and taxing actions
 - Direct policy
 - Slowly implemented

Monetary Policy

- Manipulation of the money supply to influence economic activity
 - Initial & feedback effects
- Tools of monetary policy
 - Open market operations(federal funds rate)
 - Discount rate
 - Reserve requirements

Supply-Side Policies

- Supply-siders focus on incentives and marginal tax rates
- Lowering tax rates will
 - elicit more investment
 - Improve incentives to work

12. 6 BUSINESS CYCLES

The Business Cycle

- Recurring patterns of recession and recovery—business cycles
 - Peak
 - Trough
- Industry relationship to business cycles
 - Cyclical
 - Defensive

Economic Indicators

- Leading Indicators - tend to rise and fall in advance of the economy
- Examples
 - Avg. weekly hours of production workers
 - Stock Prices
 - Initial claims for unemployment
 - Manufacturer's new orders

Economic Indicators (cont)

- Coincident Indicators - indicators that tend to change directly with the economy
- Examples
 - Industrial production
 - Manufacturing and trade sales

Economic Indicators (cont)

- Lagging Indicators - indicators that tend to follow the lag economic performance
- Examples
 - Ratio of trade inventories to sales
 - Ratio of consumer installment credit outstanding to personal income

Figure 12.6 Economic Calendar at Yahoo!

Last Week			Next Week					
Date	Time (ET)	Statistic	For	Actual	Briefing Forecast	Market Expects	Prior	Revised From
Feb 12	2:00 PM	Treasury Budget	Jan	\$38.2B	\$40.0B	\$40.0B	\$21.0B	-
Feb 13	8:30 AM	Trade Balance	Dec	-\$61.2B	-\$59.7B	-\$59.5B	-\$58.1B	-\$58.2B
Feb 14	8:30 AM	Retail Sales	Jan	0.0%	0.5%	0.3%	1.2%	0.9%
Feb 14	10:00 AM	Business Inventories	Dec	0.0%	-0.1%	0.1%	0.2%	0.4%
Feb 14	10:30 AM	Crude Inventories	02/09	-589K	NA	NA	-449K	-

FIGURE 12.6

Economic calendar at Yahoo!

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12.7 INDUSTRY ANALYSIS

Industry Analysis

- Performance can vary widely across industries
- ROE can range from 10.6% for electronic equipment to 29.2% for the cigarette industry

Figure 12.7 Return on Equity

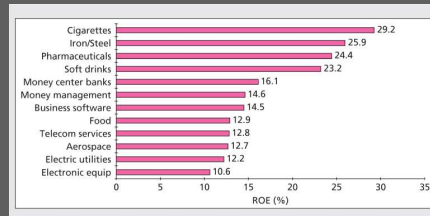
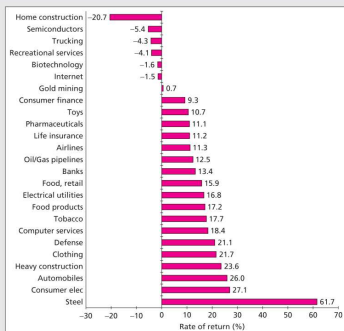


FIGURE 12.7

Return on equity
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Figure 12.8 Industry Stock Price Performance, 2006

FIGURE 12.8
Industry stock price performance, 2006
Source: The Wall Street Journal, January 2, 2007



Defining an Industry

- Where to draw the line between one industry and another
 - Money-center banks: Variation by
 - Size
 - Focus
 - Region

Figure 12.9 ROE of Major Banks, 2007

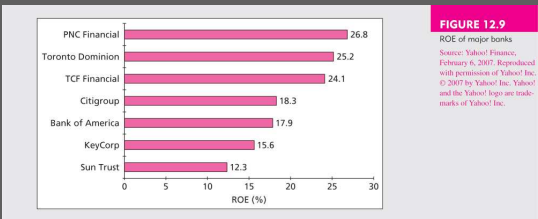


FIGURE 12.9
ROE of major banks
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North American Industry Classification System or NAICS Codes

- Codes assigned to group firms for statistical analysis
- Industry classifications are never perfect

Sensitivity to Business Cycle

- Factors affecting sensitivity of earnings to business cycles
 - Sensitivity of sales of the firm's product to the business cycles
 - Operating leverage
 - Financial leverage

Figure 12.10 Industry Cyclicity

FIGURE 12.10
Industry cyclicity. Growth in sales, year over year, in two industries.

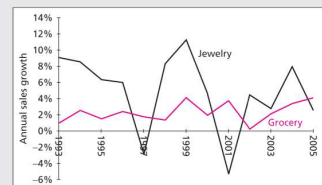
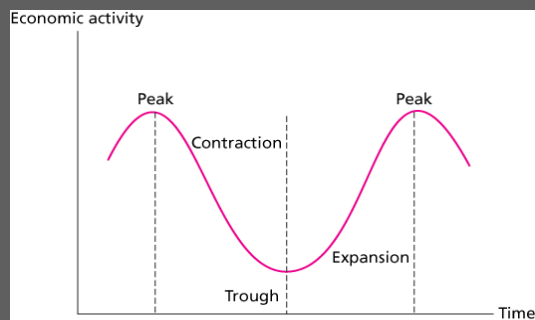


Figure 12.11 A Stylized Depiction of the Business Cycle



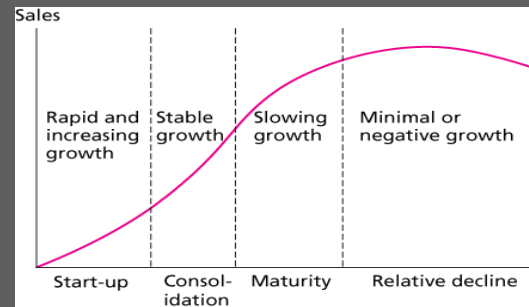
Sector Rotation

- Selecting Industries in line with the stage of the business cycle
- Peak – natural resource firms
- Contraction – defensive firms
- Trough – equipment, transportation and construction firms
- Expanding – cyclical industries

Industry Life Cycles

<u>Stage</u>	<u>Sales Growth</u>
Start-up	Rapid & Increasing
Consolidation	Stable
Maturity	Slowing
Relative Decline	Minimal or Negative

Figure 12.12 The Industry Life Cycle



Industry Structure and Performance

- Threat of Entry
- Rivalry between existing competitors
- Pressure from substitute products
- Bargaining power of buyers
- Bargaining power of suppliers