Hisse Senetleri 2015 Görünümü

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Ak Yatırım - Araştırma

BIST-100 100 bine?

BIST-100'ün 2015 görünümü ile ilgili olumlu görüşümüzü koruyoruz: 2015'te gelişmiş ülke merkez bankası para politikalarının destekleyici, gelişmiş piyasa faizlerinin de düşük kalmaya devam etmesini bekliyoruz. Dolardaki küresel yükselişin ABD ekonomisi için sıkılaştırıcı ve dezenflasyonist etkisi nedeniyle kendisini frenleyici adımlarla yavaş bir tempoda gerçekleşeceğini öngörüyoruz. Petrol fiyatlarının arz fazlası nedeniyle orta – uzun vadede düşük kalacağını öngörüyor ve uzunca bir süre 2014 yılının ilk yarısındaki seviyelerine çıkmasını beklemiyoruz. 2015'te Brent petrolün ortalama fiyatının 80 doları fazla geçmesini beklemiyoruz.

2015'te büyümenin bu senenin aksine ağırlıklı iç talep kaynaklı gerçekleşmesini bekliyoruz. Yıllık büyüme tahminimiz %3,4; ancak petrol fiyatlarındaki düşüşün öncü göstergelere olumlu etkilerini görürsek, tahminimizi %4,0'e doğru yükseltebiliriz. Cari açıkta 2015 ortalarında 40 milyar doların altını görebiliriz. Ancak iç talep artışı nedeniyle yılın ortasından itibaren enerji dışı ithalatın artması ile 2015'te cari açığın GSYH'ye oranı 2014 seviyesinin üzerine çıkabilir. Petrol fiyatlarındaki düşüş enflasyonla mücadeleyi de destekleyecek. 2015 ortasında enflasyonun %6,5'e gerilemesini ve yılı buna yakın seviyelerde tamamlamasını bekliyoruz.

Reel efektif döviz kuru (REDK) endeksi, 110 seviyelerinde bulunup TL'nin "aşırı değerli" bir bölgede olmadığına işaret ediyor. REDK'nin düşük seyretmesi, dış kaynaklı şokların kur üzerindeki etkilerinin geçici olacağına olan inancımızı pekiştiriyor. Önümüzdeki dönemde REDK'nin yükseldiğine şahit olabiliriz. REDK'nin 115'in üstüne gelmesi, TCMB'yi faiz indirimlerine yönelik cesaretlendirebilir. Enflasyonda beklenen düşüş, uzun vadeli faizlerde gözlenen gerileme ve küresel finansal koşulların elverişli kalması sayesinde, TCMB'den önümüzdeki aylarda toplamda 100 baz puana varacak düzeyde faiz indirimleri bekliyoruz.

6 ay önce BIST-100 için Haziran 2015 hedefi olarak öngördüğümüz 91.500 seviyesini 2015 yılının ilk çeyreğinde görebileceğimizi düşünüyoruz. Orta – uzun vade için kalıcı olmasını beklediğimiz 10 yıllık tahvil faizindeki düşüşe paralel olarak, indirgenmiş nakit akımı bazlı şirket değerlemelerinde kullandığımız TL cinsi risksiz getiri oranı tahminimizi %9'dan %8'e indirdik. Bunun ardından 2015 sonu için endeks hedefi tahminimiz 99.000 seviyesine yükseldi.

BIST-100'ün 10,3 seviyesindeki F/K oranı, MSCI Gelişen Piyasalar ortalamasına kıyasla %6 iskontoludur. Borsa'nın kâr verimliliğini (K/F oranı) 10 yıllık tahvil faizi ile kıyaslayarak borsa ile tahvil piyasası arasında göreceli değerleme farklarını analiz ediyoruz. Son beş senede hem Borsa'nın kâr verimliliği, hem de 10 yıllık tahvilin faizi ortalamada %9,1 seviyesinde oluşmuştu. Şimdi Borsa'nın kâr verimliliği %9,70 seviyesinde iken, 10 yıllık tahvilin faizi %7,85'e gerilemiş durumda. Aradaki 185 baz puanlık fark, Borsa'nın tahvil piyasasına göre ucuzlamış olduğuna işaret ediyor. Gelişmiş ülke faizlerinin düşük kalması ve içeride enflasyonun düşmesi yönündeki beklentilerimize paralel olarak, yurtiçi faizlerde de hızlı ve/veya kalıcı bir yükseliş beklemiyoruz. Önümüzdeki iki çeyreklik dönem içinde faizlerde özellikle kısa uçta daha belirgin olmak kaydıyla en az 50 baz puan kadar daha düşüş bekliyoruz.

Avrupa Merkez Bankası'nın (ECB) 2015'in ilk çeyreğinin sonuna kadar nicel gevşeme (QE) kapsamında devlet tahvili alımlarına geçeceğini duyurmasını bekliyoruz. Buradan doğacak atıl likiditenin yüksek getiri arayışından, Avrupa'daki periferi ülkeleri gibi gelişen piyasalar da payını alacaklardır. Ayrıca şirketlerimizin Avrupa'dan dış borç bulması da kolaylaşacaktır.

Fed'in ilk faiz artışını 2015'in sonlarında, hatta 2016 senesinde yapmasının daha olası ve makul olduğunu düşünüyoruz. Fed'i frenleyecek faktörler şunlar olabilir: (i) Çalışanların ücret enflasyonunda gerçekleşebilecek olası artışlar, fiyatlama gücü ve verimlilik sıkıntısı çeken şirketlerin kârlılıklarını bozarak ABD borsalarına sert satış getirebilir; (ii) enflasyonda düşüş görülmesi olası; (iii) demografik nedenlerle doğal işsizlik oranı beklenenden de düşük seviyelere indiyse, işsizlik gerilese de enflasyon yaratmayabilir; (iv) Avrupa'da politik belirsizlik ve ECB'nin nicel gevşeme kararında gecikme söz konusu olursa, piyasalarda azalabilecek olan risk iştahı da Fed'i beklemeye itebilir. ABD'de politika faizinin bu döngüde en fazla %3'e kadar yükseltilebileceğini öngörüyoruz (FOMC üyelerinin beklentisi: %3,75). ABD 10 yıllık tahvil faizinin önümüzdeki üç yıllık ortalama seviyesinin de %3'ü fazla geçmesini beklemiyoruz. Bu ortamın yüksek faiz getirisi ve büyüme sunan ülkelere olan fon akışlarını canlı tutmasını bekliyoruz.

FOMC üyelerinin ileriye dönük politika faizi tahminleri, piyasa beklentilerinin yüzde 1 puan kadar üzerinde seyrediyor. Fed bir yandan ekonomi ile ilgili olumsuz bir sinyal vermemek, diğer yandan finansal koşulları gereğinden erken sıkılaştırmamak, diğer bir yandan da piyasalarda balon oluşumuna izin vermemek istiyor. Bu nedenle, kendi faiz tahminlerini piyasa beklentilerine doğru aşağı çekmesini beklemiyoruz. Bunun yerine, açıklamalarında sertleşerek, piyasalarda dönemsel volatilite yaratmasını; ancak fiiliyatta faiz artışlarını piyasanın beklentilerine yaklaştıracak şekilde ertelemesini ve yavaş bir tempoda gerçekleştirmesini bekliyoruz. Beklenti yönetimi bağlamında ise, risk iştahını, faiz artışı günü geldiğinde ortada denge bulacak bir sarkaç gibi her iki yöne doğru salındırarak, nihayetinde faiz artışına yumuşak bir geçiş yapmayı hedefleyeceğini öngörüyoruz. Bu da o zamana kadar yüksek marjlı sert iniş ve çıkışların yaşanacağı ve düşüşlerin alım fırsatı yaratacağı bir piyasa ile yüzleşebileceğimize işaret ediyor.

En çok önerdiğimiz hisseler: Aselsan, Çimsa, Emlak GYO, İş Bankası, Kardemir, Pegasus, Tekfen Holding, Vakıfbank ve YKB.

Hisse Senedi Portföy Önerisi

3 Aralık 2014
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Son Değişiklik (3/12/14): Albaraka'yı portföy önerilerimiz arasından çıkarıyoruz. Pegasus, Vakıfbank ve Yapı Kredi'yi portföyümüze ekliyoruz.

Portföy Öneri Listesi (3/12/2014) – Aselsan, Çimsa, Emlak GYO, İş Bankası C, Kardemir D, Pegasus, Tekfen, Vakıfbank, Yapı Kredi.

En az Beğendiğimiz Hisseler Listesi: (3/12/2014) – Ak Enerji, BİM, Hürriyet.

Portföy Önerileri			En az beğendiklerimiz		
Şirket	Kod	HisseFiyatı	Şirket	Kod	HisseFiyatı
Aselsan	ASELS	10.80	Akenerji	AKENR	1.32
Çimsa	CIMSA	16.15	BİM	BIMAS	50.00
Emlak GYO	EKGYO	2.71	Hürriyet	HURGZ	0.90
İş Bankası	ISCTR	5.81			
Kardemir D	KRDMD	2.08			
Pegasus	PGSUS	32.00			
Tekfen Holding	TKFEN	5.93			
Vakıfbank	VAKBN	5.02			
Yapı Kredi	YKBNK	5.23			

Kaynak: Ak Yatırım – Hisse fiyatları 2 Aralık itibarıyladır.

Portföy Performansı

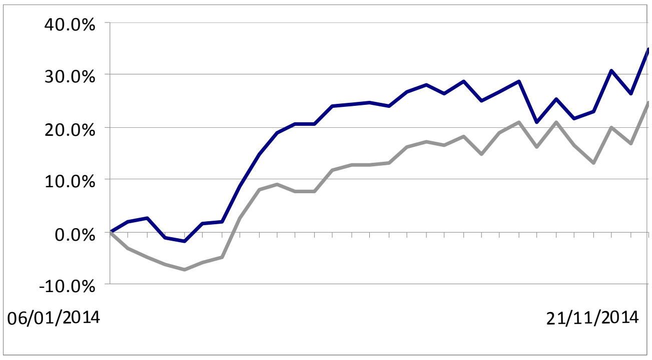
ÖneriListemizin 6 Ocak 2014'deki başlangıç tarihinden beri nominal veBIST-100 getiri endeksine göre relatif getirisi sırasıyla %34.5 ve %5.8 olarak gerçekleşmiştir.

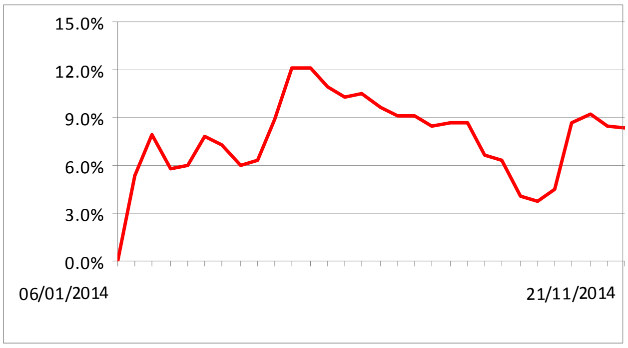
Portföy Perfomansı		Hisse fiyatı 21/11/14	Hisse fiyatı 02/12/14	Performans Nominal	Performans Endeks Rel*	Listeye giriş tarihi	Listeye girişten beri perf. Nominal	Listeye girişten beri perf. Endeks Rel*
Albaraka Türk	ALBRK	1.74	1.73	-0.6%	-2.5%	03/11/2014	9.5%	3.2%
Aselsan	ASELS	10.70	10.80	0.9%	-1.0%	12/09/2014	14.3%	4.7%
Cimsa	CIMSA	15.80	16.15	2.2%	0.2%	17/10/2014	5.2%	-6.4%
Emlak GYO	EKGYO	2.69	2.71	0.7%	-1.2%	03/11/2014	7.1%	0.9%
Isbank	ISCTR	5.82	5.81	-0.2%	-2.1%	17/10/2014	13.0%	0.5%
Kardemir D	KRDMD	2.18	2.08	-4.6%	-6.4%	03/11/2014	-15.8%	-20.6%
Tekfen Holding	TKFEN	6.00	5.93	-1.2%	-3.1%	19/06/2014	14.7%	6.8%
		Ortalama getiri		-0.4%	-2.3%			
BIST-100 Getiri Endeksi		121,242	123,620	2.0%				

*Kaynak: AkYatırım * BIST-100 getiri endeksine göre relatif*

Portföy Önerileri

Portföy Performansı: Nominal | **BIST-100 Getiri End. relatif**





Kaynak: Ak Yatırım

ASELSAN			**ASELS TI**		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**	
10.80		13.20		19%	
	2014T	**2015T**		**2014T**	**2015T**
FD/VAFÖK	12.3	10.4	**F/K**	13.5	11.4

Aselsan'ın faaliyetleri ekonomik çalkantılardan etkilenmiyor çünkü Türkiye'de ve bölgede savunma harcamalarında kesintiler yapılmıyor.

Aselsan'ın önümüzdeki yıllarda üzerinde çalıştığı projelerden 4 milyar dolar ciro bekliyor. Çoğu projeleri Savunma Sanayi Müsteşarlığındandır; örneğin Milgem 3. ve 4. gemileri, Altay tank ihalesi ve uzun menzilli hava savunma füze sistemi. Son haberlere göre, bu füze sistemi için Çinliler yerine Fransızlarla görüşülmeye başlanmış. Bu da olumlu bir gelişme olarak görülüyor.

Aselsan global benzerlerine göre primli işlem görüyor ancak daha hızlı büyüdüğünden dolayı şirketin bu primi hak ettiğini düşünüyoruz

ÇİMSA			**CIMSA TI**		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**	
16.15		19.00		18%	
	2014T	**2015T**		**2014T**	**2015T**
FD/VAFÖK	6.2	5.9	**F/K**	10.0	9.3

9A14 itibariyle Cimsa'nın cirosu yıllık %12, VAFÖK marjı ise %31.4'e yükseldi (9A13'te VAFÖK marjı %24.5 idi). Marjda yaşanan iyileşme kuvvetli seyreden yurtiçi çimento (gri ve beyaz) fiyatları ve enerji maliyetlerinde yıllık bazda yatay seyir izlemesinden kaynaklanmaktadır. Çimsa'nın 2014 yılında cirosunun yıllık %14 artmasını ve VAFÖK marjının %30'a çıkmasını bekliyoruz. Ayrıca, 2013-2016 yıllarında Çimsa'nın cirosunun her yıl ortalama %9, VAFÖK'ünün ise her yıl ortalama %13 büyümesini öngörüyoruz. Afyon Çimento'da planlanan kapasite artışını (yıllık 0.5mn ton klinker üretim kapasitesinin 1.5mn tona çıkarılması) 2016 yılı sonunda faaliyete geçecek şekilde modelimize ekliyoruz. Güçlü seyreden operasyonların yanı sıra, Rekabet Kurulu onayında bekleyen Sancim çimento satın alımı ile ilgili haberlerin hisseyi olumlu etkileyebileceğini düşünüyoruz.

EMLAK GYO			**EKGYO TI**		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**	
2.71		3.65		35%	
	2014T	**2015T**		**2014T**	**2015T**
FD/VAFÖK	10.8	8.1	**F/K**	11.3	8.8

Emlak GYO hisseleri için olumlu görüşümüzü sürdürüyoruz. Hisselerin değerleme açısından cazip olduğunu düşünmekle beraber, hissenin düşen faiz ortamından olumlu etkilenecek şirketlerin başında olduğunu düşünüyoruz. Buna göre Emlak GYO hisseleri en son açıklanan NAD'ına (Net Aktif Değeri) göre %21 iskontolu işlem görmektedir (tarihsel ortalama iskonto %15 seviyesinde).

Şirket 2014 yılında toplam 10 bin konutluk ön satış hedefine ulaşabileceği konusunda kararlı (bizim yıl sonu 10 bin konut ön satış beklentimize paralel). Bu sebeple önümüzdeki aylarda yeni proje lansmanları ile aylık konut ön satışlarının artmasını bekliyoruz. Belirtmek gerekirse, Ekim sonu itibariyle Emlak GYO'nun ön satışları toplam 7,533 adete ulaştı

İŞ BANKASI C			**ISCTR TI**		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**	
5.81		7.30		26%	
	2014T	**2015T**		**2014T**	**2015T**
F/DD	0.9	0.8	**F/K**	7.9	7.1

Beklentimiz üzerinde 3Ç14 net karı açıklayan İş Bankası için 2014 ve 2015 kar beklentilerimizi %6 ve %5 artışla 3.300 milyon TL ve 3.520 milyon TL düzeyine çektik.

Bankanın üçüncü çeyrek karlılığının beklentiler üzerinde gelmesinde swap maliyetlerinin azalması, bono alım/satım karları ve 100 milyon TL serbest karşılık iptalinin yanı sıra net faiz marjının dirençli kalması ve komisyon gelirlerinin (olumsuz mevsimselliğe rağmen) kuvvetli olması önemli etkenlerdi.

Bankanın 12 aylık hedef değerini hisse başına 6,40 TL olarak koruyoruz. Yüzde 26 artış potansiyeli taşıyan hissede görüşümüz 'Endeksin Üzerinde Getiri' olarak korunuyor.

KARDEMİR D			KRDMD TI		
Cari Fiyat (TL)		12A Hedef (TL)		Potansiyel	
2.08		2.90		39%	
	2014T	2015T		2014T	2015T
FD/VAFÖK	6.4	6.5	F/K	11.3	11.2

3Ç14'de Kardemir beklenen'den düşük mali sonuçlar açıkladı. 3Ç14 VAFÖK marjı %23,4 olarak gerçekleşti ki beklenti %27 seviyelerdeydi. 3Ç14 Şirket daha çok düşük kar marjlı kütük üretip sattı. İleriye dönük de bu ürünün daha çok satış portföyünde yer lamsını bekliyoruz. Ayrıca Çin'den gelen ürünler de piyasayı olumsuz etkilemesini bekliyoruz. Ancak bu olumsuzluklara rağmen hisse ile ilgili olumlu görüşümüzü koruyoruz çünkü halen yüksek karlılığa sahip; düşük hammadde fiyatları avantajı devam ediyor.

Ayrıca, 2015 sonunda yeni konvertörlerin devreye girmesiyle 2014 sonunda devreye giren 5nci fırınla artan kapasite kütük dışında daha yüksek kar marjlı ürünler üretilecek ve 700 bin tonluk filmaşin haddehanesi devrede olması bekleniyor. Bu tesis de katma değerli ürünler üretecek. Bunlar da karlılığı yüksek tutacak.

PEGASUS			PGSUS TI		
Cari Fiyat (TL)		12A Hedef (TL)		Potansiyel	
32.00		38.00		%19	
	2014T	2015T		2014T	2015T
FD/VAFÖK	9.9	7.9	F/K	13.9	12.6

Pegasus Hisseleri son 1.5 aylık dönemde beklentilerin üzerinde gelen 3Ç finansal performansı ve özellikle hızla gerileyen petrol fiyatlarına bağlı olarak endeksin %12 üzerinde getiri sağladı. Biz bu trendin bir süre daha devam edeceğini düşünüyoruz. Bu görüşümüzdeki temel dayanağımız petrol fiyatlarındaki düşüşün devam edeceği beklentisidir. Yakıt giderleri Pegasus'un nakit maliyetlerinin %44'ünü oluşturmaktadır. Hedge stratejisi nedeniyle petrol fiyatlarındaki düşüşün Pegasus'un finansallarına olumlu etkisi kademeli olarak yansıyacak olsa da uzun vadeye yayılan düşük fiyat öngörüsü şirket için karlılık beklentilerine desteklemektedir.

TEKFEN HOLDİNG			TKFEN TI		
Cari Fiyat (TL)		12A Hedef (TL)		Potansiyel	
5.93		7.82		32%	
	2014T	2015T		2014T	2015T
FD/VAFÖK	5.1	4.7	F/K	7.4	8.7

Potansiyel projeler arasında yer alan Socar'ın Star Rafineri projesi (yaklaşık proje büyüklüğü 500mn dolar) ve TANAP (3 bölümden oluşan projenin yaklaşık toplam büyüklüğü 1,5-2,0 milyar dolar) projesi ile ilgili olası olumlu haber akışı şirket için kısa vadeli katalist olabilir. Tekfen 2015 F/K oranı olan 8,5 ile, uluslararası benzer şirketleri ortalaması olan 10,4 ve yerli benzer şirketlerin ortalaması olan 12,0'a göre iskontoda işlem görüyor. Toros Tarım'ın bu yıl sonuna kadar tamamlanması beklenen 300mn dolarlık sülfürik asit-fosforik asit projesinin şirketin tarım segmenti EBITDA marjının geçmiş 8 yılın ortalaması olan %11,8'ya göre 50 baz puan artışla 2015 yılında %12,3 olarak gerçekleşmesini bekliyoruz.

VAKIFBANK			VAKBN TI		
Cari Fiyat (TL)		12A Hedef (TL)		Potansiyel	
5.02		6.10		22%	
	2014T	2015T		2014T	2015T
F/DD	0.9	0.8	F/K	8.4	7.2

Vakıfbank için 2015 kar tahminimizi %25, 2016 kar tahminimizi %7 yukarı revize ediyoruz. Bu paralelde 12 aylık hedef fiyatımızı da 6,10 TL seviyesine yükseltiyoruz. Hisse için performans beklentimizi de "Endeksin Üzerinde Getiri"ye revize ediyoruz. Vakıfbank bilançosundaki vade yapısı ve yüklü TL pozisyonu nedeniyle genişlemeci politikalardan fayda elde edecek diğer bir banka. Diğer taraftan Visa ve Mastercard hisselerinin satışına ilişkin karar alındı. Bankanın bu satıştan 250-300mn TL gelir elde etmesini bekliyoruz.

YAPI KREDİ BANKASI			YKBNK TI		
Cari Fiyat (TL)		12A Hedef (TL)		Potansiyel	
5.23		6.30		20%	
	2014T	2015T		2014T	2015T
F/DD	1.3	1.2	F/K	12.3	9.9

Yapı Kredi'de sektör ortalamasından daha hızlı büyüme beklentisi piyasa tarafından olumlu karşılanıyor. Yapı Kredi yıl başından bu yana banka sektör endeksinin %6, BIST100'ün ise %12,5 üzerinde performans gösterdi. Yapı Kredi için performans beklentimizi büyüme planı çerçevesinde "Endeksin Üzerinde Getiri"ye revize ediyoruz. Hisse için 12 aylık hedef fiyatımız olan 6,30TL %20 yukarı potansiyel ifade etmektedir.

En az beğendiklerimiz

En Az Beğendiğimiz Hisselerin Performansı

En az beğendiğimiz hisselerin ortalama getirisi BİST-100 getiri endeksine göre 20 Ocak 2014'den bugüne -%3.2 olmuştur.

En Az Beğendiğimiz hisseler		Hisse fiyatı 21/11/14	Hisse fiyatı 2/12/14	Performans Nominal	Performans Endeks Rel*	Listeye giriş tarihi	Listeye girişten beri perf. Nominal	Listeye girişten beri perf. Endeks Rel*
Akenerji	AKENR	1.32	1.32	0.0%	-1.9%	12/09/2014	16.8%	7.0%
Anadolu Efes	AEFES	49.85	50.00	0.3%	-1.6%	20/01/2014	0.3%	-1.6%
Hürriyet	HURGZ	0.82	0.90	9.8%	7.6%	12/09/2014	45.2%	32.9%
			Ortalama getiri	3.4%	1.4%			
BIST-100 Getiri End.		121,242	123,620	2.0%				

*Kaynak: Ak Yatırım * BIST-100 getiri endeksine gör erelatif*

AK ENERJİ		AKENR TI		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**
1.32		1.25		-5%
	2014T	**2015T**	**2014T**	**2015T**
FD/VAFÖK	34.0	10.1	F/K -	-

Ak Enerji 2015T 10,1x FD/VAFÖK çarpanıyla işlem görürken, gelişmekte olan piyasa benzer şirket çarpanı 8.7x seviyesinde bulunuyor. Yurt içi benzer şirket olan Aksa Enerji'nin FD/VAFÖK çarpanı ise 8.7x.

Ekim ayında doğalgaz ve elektrik fiyatlarına yapılan eşit orandaki artış doğalgaz santralleri açısından olumlu olsa da, Akenerji'nin yüksek borçluluğu nedeniyle 2015 çarpanlarının ilgi uyandıracak düzeyde olmadığını düşünüyoruz.

BIM		BIMAS TI		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**
50.00		50.00		0%
	2014T	**2015T**	**2014T**	**2015T**
FD/VAFÖK	22.8	16.9	F/K 36.0	26.2

Hisseyi çarpan bazında pahalı bulmaya devam ediyoruz. Ayrıca piyasanın 2014 yıl sonu tahminlerinde aşağı revizyon olmasını bekliyoruz.

Bloomberg konsensüs tahminlerinde hala %4.7 VAFÖK marjı beklenirken, 9A14'te VAFÖK marjı %4.5 oldu. Önümüzdeki çeyreklerde gıda enflasyonun düşmesini bekliyoruz, bu da Bim'in satış büyümesinde olumsuz etki yaratmasını bekliyoruz.

HÜRRİYET		HURGZ TI		
Cari Fiyat (TL)		**12A Hedef (TL)**		**Potansiyel**
0.90		0.61		-32%
	2014T	**2015T**	**2014T**	**2015T**
FD/VAFÖK	12.1	11.1	F/K -	-

- 3Ç14'de 16mn TL net zarar açıkladı. Bu CNBCe konsensüs tahmini olan 9mn TL ve bizim tahminimiz olan 5mn TL net zararın altında. Beklentilerin altında gerçekleşen net zarar rakamı hem operasyonel zayıflık hem de yüksek finansman giderlerden kaynaklandı. 3Ç14 ciro yıllık bazda %13 ve çeyrek bazda %23 daralma ile 164mn TL olarak gerçekleşti ve konsensüs tahmini olan 189mn TL ve bizim tahminimiz olan 191mn TL'nin altında gerçekleşti. 3Ç14 VAFÖK kar marjı %2,2 ile 3Ç13'deki %8,8 ve 2Ç14'deki %14,7'nin altında gerçekleşti. Konsensüs tahmini 3Ç14 VAFÖK marjını %9,1 beklerken biz %10,1 bekliyorduk.

- Zayıf devam eden operasyonel sonuçlar ile 2014 ve 2015 tahminlerimizi aşağıya revize etmiştik. Mevcut 12 aylık hedef fiyatımız 0,61 TL; 'endeksin altında getiri' önerimizi koruyoruz.

Turkish Equity Strategy
2015 Outlook

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Ak Investment Research Team

BIST-100 to 100K?...

We see Turkish equities in a "sweet spot", poised to continue delivering on a raft of supportive factors: i) accommodative G3 central banks and lower core market yields, ii) a stabilization in EMFX (with the TRY still offering the highest implied-volatility-adjusted 1m carry among EMFX peers after INR), iii) a cyclical decline in the CAD fortified further by falling oil prices), iv) the 2015 inflation dividend on local and global factors, also enhanced by lower oil prices, and which should pave the way for 100bps in CBRT rate cuts over the coming few months and, v) undemanding stock valuations relative to bonds, peers and own history.

Everything cooking in line with our arguments in our strategy report "Where has the cycle gone?" dated June 05, 2014, setting out a dovish stance we have maintained since then. Despite bouts of market interruptions with geopolitical worries and a round of "unfounded" Fed worries, we are back on track. Our main argument then was "lower rates for longer"; now this is leveraged by the supply-driven "lower oil prices" catalyst, creating a Goldilocks backdrop for the Turkish investment theme.

Our 12-month BIST-100 target is 99,000, offering 15% upside. We had forecasted a June 2015 BIST-100 target of 91,500 nearly six months ago. We now think we may see these levels as early as February. At a 2015 P/E of 10.5x (vs. a historical average of 10.6x), Turkish equities trade at a 5.4% discount to the MSCI EM average (vs. a 4.2% historical average discount since 2009).

The Fed model suggests potential for a slimmer equity risk premium… The BIST-100's 12M earnings yield of 9.48% marks a 174bps premium over the 7.75% yield on the 10Y local government bond yield. Both measures have averaged 9.1% over the past 5 years, while the maximum ERP has reached 239bps, implying a superior risk/reward profile for equities, notwithstanding a sharp rise in yields, which is not in our baseline scenario for 2015.

Yields to fall further… On the contrary, we still see further downside in the 10Y local government bond yield to below 7.50%, sucked lower by sharp declines in inflation over the next six months, which should push multiples in Turkish stocks higher still. As such, we have cut our TRY-based Cost of Equity assumption from 14.5% to 13.5% (for $\beta = 1$), now incorporating a TRY-based RfR of 8.0% (previously 9.0%) and we expect the 2Y local government bond yield to price in the CBRT's expected rate cuts more quickly, sliding towards 7.00%, with even lower levels not out of the question. Once market yields bottom out, earnings growth will have to take the baton in pushing equity multiples higher.

The global story of weak to moderate growth, low inflation and extreme monetary easing will remain in place for at least another year. This suggests that the path of least resistance for equities is upwards for some time yet. That said, Yellen may be the "Grinch" of this equilibrium as the Fed can engineer higher volatility in the markets to avoid a hard landing between a rock ("a premature exit") and a hard place ("a financial bubble"), by delicately adjusting the inconsistency between the FOMC members' "dots" and market expectations for fed funds trajectory. We think the ECB's inevitable move towards sovereign QE, coupled with our expectation of pricing in of a delayed Fed lift-off towards the latter part of 2015, if not 2016, should support liquidity-addict EMs over the next year, despite higher volatility resulting in a broader seesaw pattern in a two-step-forward – one-step-backward fashion as risk appetite swings like a pendulum. In short, asset bubbles and price volatility could be the key words for 2015.

In the current backdrop, the USD rise would be the major impediment holding back the BIST, but even though the greenback might have begun a long-term, multi-year bull market, we think this could also prove a stumbling, stuttering advance. Our rationale is that the U.S. cannot itself hit escape velocity, while a stronger dollar could be self-defeating due to its tightening impact and deflationary impulse on the U.S. economy, which cannot easily absorb a major exchange rate re-alignment, forcing U.S. Treasuries to be a "relief valve". This would lead to a slower exit path by the Fed. We expect a lower terminal funds rate of 3% or less in this cycle with the UST 10Y yield to average just over 3% throughout the next three years - in turn attracting more easily-attracted capital inflows into EMs, propping up carry trades and inflating assets with earnings streams.

Turkey to benefit from ECB reflation trade… The ECB's QE, which we expect to start in 1Q15, will place the Eurozone as the main exporter of capital for the rest of the decade, as excess liquidity drives down rates through a "search for yield". The Turkish private sector's borrowing from Europe would then ease further, while any acceleration in the Eurozone should also boost Turkey.

Supply overhang in oil likely to remain in place in the longer run, supporting Turkey's investment theme as a major importer. We do not expect a permanent rebound in oil prices to 1H14 levels. No cut from OPEC and large build up in 1H15 inventories assure us that a large oil market surplus is likely in 1H15 and anchor in a bearish outlook for oil prices - a boon for Turkey.

Our most-preferred stock ideas: Isbank, Vakifbank, Yapi Kredi, Aselsan, Cimsa, Emlak REIC, Kardemir, Pegasus and Tekfen Holding.

Table of Contents

Investment Theme

Keeping the faith…

In our strategy report "Where has the cycle gone?", dated June 05, 2014, we had set our June 2015 target of 91,500 for the BIST-100 index. We now have a higher conviction that the index could reach this target as early as February 2015, if not earlier.

Here are a few justifications for our bullish view:

- **We have set our 12-month BIST-100 target at 99,000** in view of the continued global accommodative monetary backdrop, further backed by the increased potential for sovereign QE from the ECB in 1Q15, and an improving inflation and interest rate outlook at home, prompting a reduction in our TRY-based risk-free-rate from 9.0% to 8.0% in our Cost of Equity calculations, as well as an improvement in earnings.

- **EPS revision trend represents a significant positive over CEEMEA peers...** Consensus EPS forecasts for 2014/15 have been raised by nearly 7% over the past six months, while EPS forecasts for the MSCI EM and MSCI EMEA have been cut by 8% and 12%, respectively.

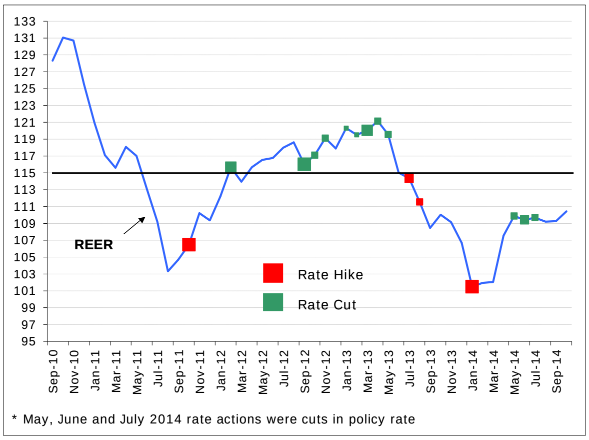
- **… which is reflected in the still-present discount of Turkish stocks vs. the EM averages despite the market outperformance so far this year (and more noticeably, in the rally since October 8th).** We calculate a 2015F P/E multiple of 10.5x for the BIST-100 index, marking a 5.4% discount to the MSCI EM average of 11.1x, which we deem unjustified in a period of particular relative strength in the Turkish macro backdrop. The closure of this valuation gap with respect to the MSCI EM multiple would be sufficient for the BIST to reach our June 2015 target earlier than implied.

- **The equity risk premium of the BIST has been on the rise lately, as implied by the surplus of the BIST-100's earnings yield over the 10Y local government bond yield.** This hints that the bond market has been pricing in positive expectations more rapidly than the equity market since August, when earnings yields and bond yields were on a par with each other. The BIST's earnings yield now stands at 9.48%, 174bps above the 10Y local government bond's yield of 7.75%. The yield surplus in favour of equities has never exceeded 239bps in the past five years, while the average yield surplus has been a mere 3bps (both yield measures averaged 9.1% during this period), now furnishing equities with a superior risk/reward profile.

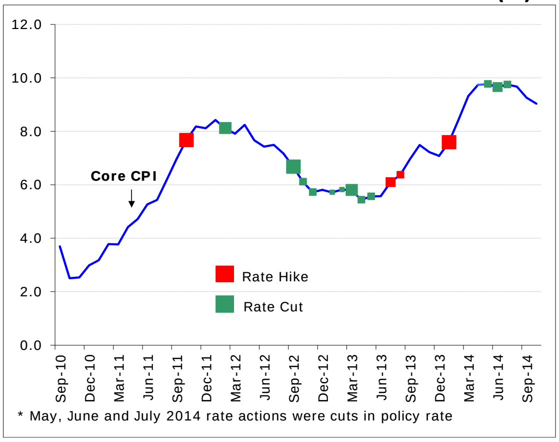
- **And this only represents the picture taken today. We expect the 10Y government bond yield to slide below 7.50% on an ever more improving inflation outlook, which means that equities will get even cheaper!** Note that we expect a bull steepening over the coming months as we expect the 2Y local government bond yield to price in the CBRT's expected rate cuts at a faster pace, and slide towards 7.00%, with even lower levels not out of the question.

- **We have been expecting a further 100bps of rate cuts from the CBRT in 1H15 to bring the weekly policy rate to 7.25%, a call we have maintained since 2Q14, which may be frontloaded early in the new year, with a move in that direction possibly even resuming as early as this month.** Our expectation is grounded on (i) lower core inflation, and a diminished effect of devaluation on core inflation, (ii) subdued unit wages, (iii) a favourable base effect on 1H15 inflation, and last but not least, (iv) benign global liquidity and financial market conditions. Recall that the TRY still offers the highest implied-volatility-adjusted 1m carry among EMFX peers after the INR, also providing some leeway for rate cuts in the short-term once inflation readings and/or expectations improve, which we expect to ensue over the next two months.

REER Index and the CBRT's Rate Actions



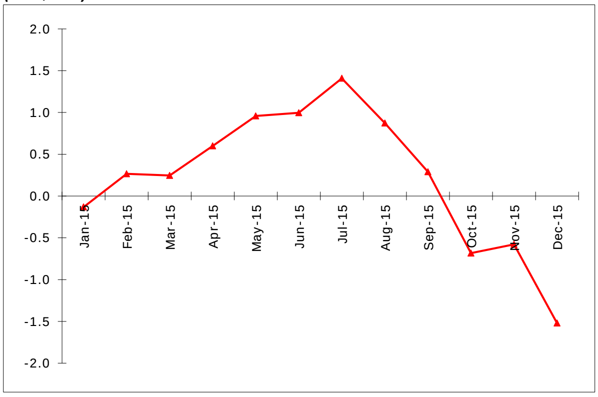
Core Inflation and the CBRT's Rate Actions (%)



- **A reduced Treasury debt service is also supportive for lower rates…** Another factor which will keep bond yields lower will be the easing in the domestic debt service burden on the Turkish Treasury. In contrast with the total TRY157bn debt repayment in 2014, the Treasury will only complete TRY107bn of debt redemptions in 2015, with a projected roll-over target of 82% for 2015. Apart from the supportive global monetary conditions, we believe the decline in the Treasury's domestic borrowing will also help keep interest rates reined in next year. Another supporting factor to this supply-side relief comes from the demand side: Local banks will be aggressive bidders in local auctions in their roll-overs, in our view, as credit growth will remain curbed at around 15%, leaving no alternative use of their excess liquidity.

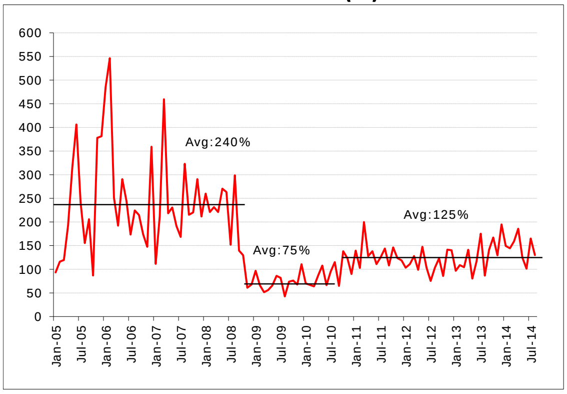
- **As long as the CBRT allows inflation to moderate further before easing policy, this should cap any fall in the TRY against the USD.** The CBRT is in a stronger position to deal with exchange rate volatility with the upper bound of the interest rate corridor at 11.25%. We do not expect any material upward pressure on the TRY, due to exogenous shocks, thanks to the undemanding REER level of 110, as well as the lower projected portfolio flow need in financing the 2015 current account deficit, as indicated in the chart below.

Turkey - 2015 Portfolio Flow Need*
(US$bn)



** Negative figure shows CAD to be financed with portfolio flows*

Banks and Non-banks - Total Long-term External Debt Roll-over Ratio (%)



- **Turkey has a large but steady foreign investor base…** Foreign ownership of the free float in the BIST is 64%, closer to the lower end of the 61% - 73% range that has been observed since 2006, implying that positioning is not heavy. Meanwhile, Turkey is also attracting some of the funds flowing out of Russia in regional portfolios due to Russia's geopolitical woes. Moreover, the rapid growth in the Turkish domestic pension fund industry (expected CAGR of at least 25% until 2020) augurs well for the growth of local institutional investors in the stock market. The deepening of the investor base in the BIST should justify higher equity multiples.

Most-preferred stocks

ISCTR: Isbank remains a top pick with its attractive valuation and strong 1H15 earnings catalyst.

VAKBN: We have raised **Vakifbank's** rating to 'Outperform' and included it in our top picks, since the bank is a major beneficiary of the easing cycle. Additionally, the management's recent decision to divest its Visa and Mastercard shares is likely to boost its bottom-line by more than 15% in 2015.

YKBNK: We include **Yapi Kredi Bank** among our top picks on the back of its attractive growth plans as the bank plans to increase its market share in loans to 14% within 5 years (from the current 9.8%).

ASELS: We like **Aselsan** as it has an appealing upside with near-term triggers on expected tender announcements.

CIMSA: We favour **Cimsa** on the back of its high-margin, diversified product portfolio (i.e. white cement), organic growth potential and high dividend yield (~9%).

EKGYO: Emlak REIC is a major beneficiary of falling interest rates that should support the company's unit sales and pre-sales revenues in 2015.

KRDMD: Kardemir is at an attractive entry level, in our view, as we see long-term value with completion of investments.

PGSUS: Pegasus Airlines is among the major beneficiaries of the falling oil prices, with fuel costs making up 44% of the total cash costs.

TKFEN: In addition to potential short-term catalysts (i.e. TANAP and Star refinery project), **Tekfen Holding** also has attractive multiples.

Our top stock ideas

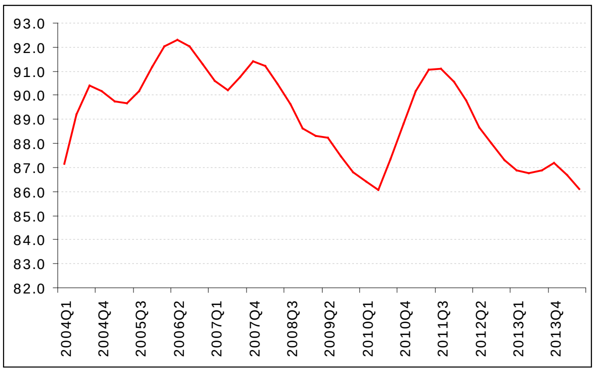
Company	12m TP (TRY)	Upside	2015 P/E
Aselsan	13.20	19%	11.7
Cimsa	19.00	21%	9.1
Emlak REIT	3.65	29%	9.1
Isbank	7.30	19%	7.5
Kardemir D	2.90	36%	11.5
Pegasus	38.00	17%	12.7
Tekfen Holding	7.82	30%	8.6
Vakifbank	6.10	20%	7.3
Yapi Kredi	6.30	18%	10.1

Please go to page 28 for one-pagers on our top picks.

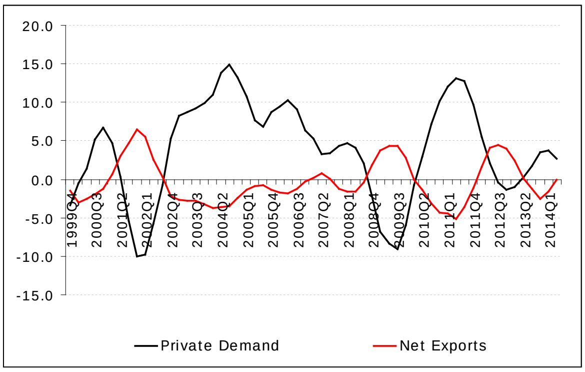
Turkish macro: Lower oil prices to further support 2015 outlook…

We expect a recovery in private sector demand in 2015... Thanks to a slimmer current account deficit and improved quality of financing, we expect a real appreciation in the TRY, which, along with the expected CBRT rate cuts, should support domestic demand and assist the disinflation process.

Private Demand (Annual, % of GDP)

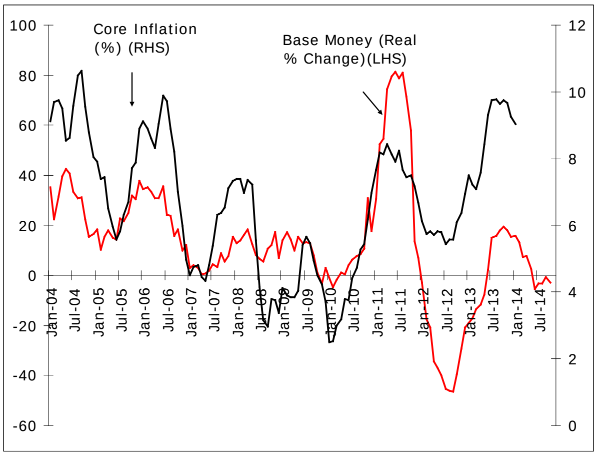


Private Demand – GDP Contribution (Annual, pps)

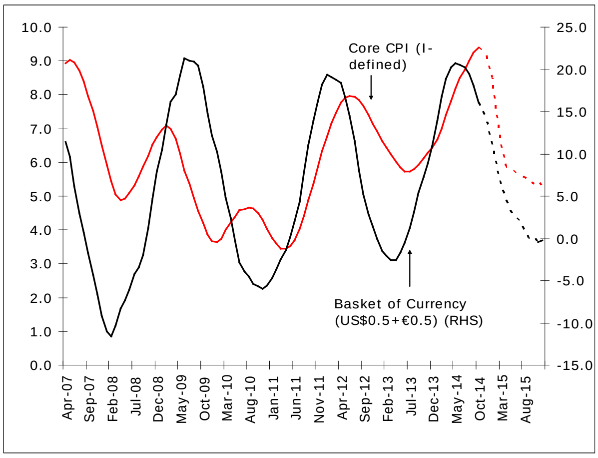


Inflation will surprise on the downside in 1Q15, on the back of global disinflation encompassing lower commodity and food prices, modest domestic demand and a higher real effective exchange rate, paving the way for the CBRT to cut rates. A reversal in food price inflation to its longer-term trend (thanks to supply relief and government measures) would shave 1pp off CPI inflation, while supportive base effects, a fading exchange rate effect and a falling money supply (which leads the CPI by around 9 months) may offer positive surprises for core inflation in 2Q15. We expect the rate of CPI inflation to fall from 9.0% in October 2014 to 6.5% by mid-2015 and remain near that level until the end of 2015.

Base Money and CPI Inflation (9 months lag)
(YoY % Growth)

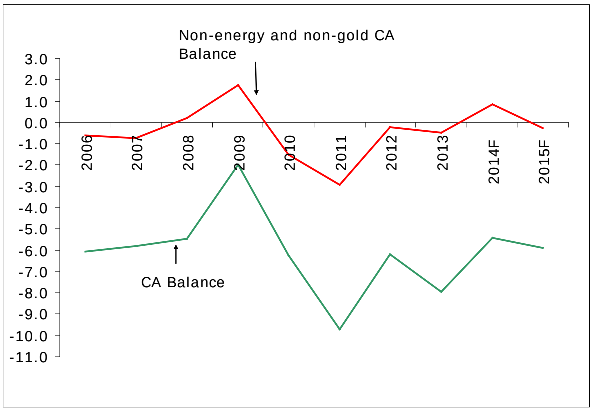


Core CPI and Basket of Currency (9 month MA)
(YoY % Growth)

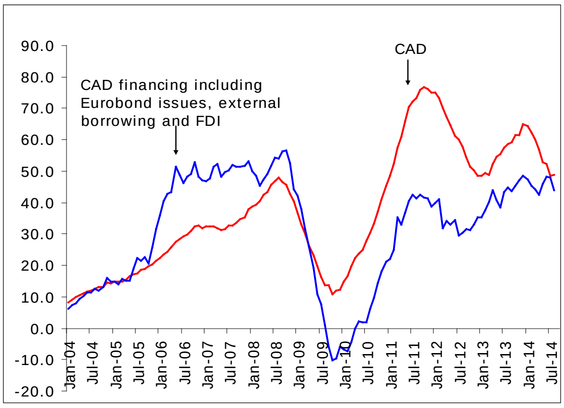


External rebalancing to continue in 1H15… A macro adjustment to tackle external weakness has been under way, with the C/A deficit on a narrowing trajectory as domestic demand has slowed down with loan growth pegged back near the CBRT's desired 15% level, while the exchange rate is also much more helpful with an REER of 110 - an undervalued territory versus the trend, suggesting that net exports remain the main contributor to GDP growth. As such, the CAD is unlikely to prove troublesome, with inflation set to subside as Turkey's growth then comes within its potential output boundary.

Current Account Balance (% of GDP)



CAD Financing (Annual US$bn)



- Trade indicators (export/import volumes and terms of trade) reveal the ongoing improvement while prices of imported commodities are weaker.

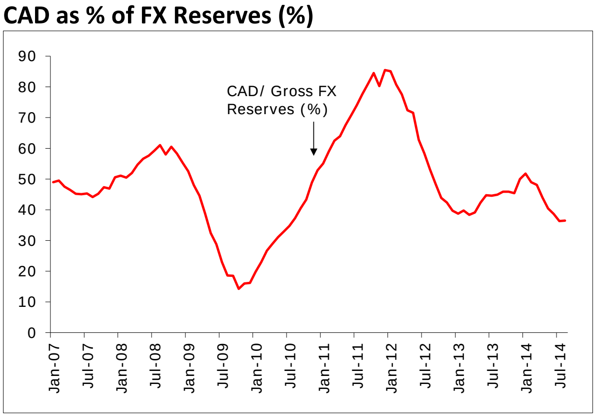
- The non-energy – non-gold current account has been in surplus in 2014 for the first time in five years.

- We have also observed a significant improvement in the financing of the deficit. The financing structure of the deficit has changed from one dominated by portfolio investment to one by bank sector borrowing (including Eurobond issues). On the whole, financing has been unproblematic on a recovery in portfolio flows since March, a stable FDI, comfortable debt roll-overs, the manageable / largely-hedged short FX position of corporations, increasing CBRT reserves and contained TRY volatility. For 2015, we compare the CAD with total financing consisting of Eurobond issues, external borrowing and foreign direct investment. The gap between the deficit and its financing has largely closed since 2H11, thanks to the declining deficit and the strengthening capital flows.

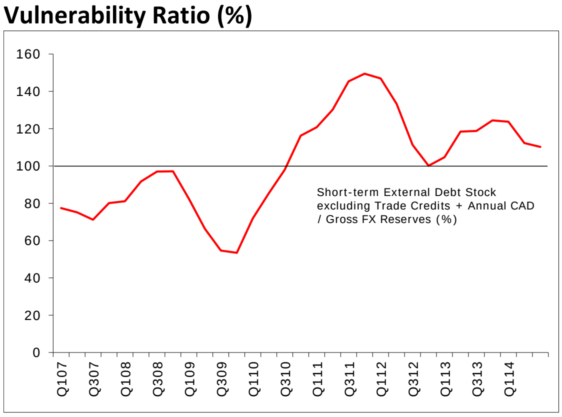
- The CBRT's latest financial stability report proposes that the possible negative effect of rate cuts on financial stability will be offset by macro-prudential measures. The report underlines that measures to encourage prudent borrowing will be vital. We understand the CBRT will effectively deploy the reserve requirement policy and the reserve option mechanism in 2015. The report also suggests that the ratio of reserves to short-term external debt payments will improve in 2015, hinting at a possible increase in the coefficients in the reserve option mechanism.

- All in all, the combination of global monetary conditions - which we expect to remain highly accommodative - and a flexible CBRT do serve to ease any worries one may have over the CAD that could be associated with the talk of a Fed "exit".

CAD as % of FX Reserves (%)



Vulnerability Ratio (%)



Further improvements in inflation, the external balance and growth outlook amid declining oil prices… The recent moves in commodity prices are of a magnitude significant enough to give rise to meaningful terms-of-trade shock for Turkey. As an importer, Turkey stands as one of the cyclical beneficiaries of lower oil and commodity prices among a raft of EMs struggling with structural problems in a stagnant global economy. Lower oil prices will support Turkey's efforts to tackle its CAD and bring down inflation in 1H15, while they may also bring forward the pick-up in domestic demand to an earlier part of the year.

- **Turkey's annual energy bill would fall from US$55.5bn in 2014 to US$45.3bn in 2015 on the assumption of an average US$80/bbl Brent crude price – hence giving rise to a US$10.2bn (1.2% of GDP) saving in the energy bill in 2015.** This could narrow the 2015 CAD to 5.2% of GDP from an estimated 5.4% in 2014 (with an almost balanced current account if energy and the net gold trade were excluded). Yet, while we expect the CAD to fall to around US$40bn in 1H15 on the back of lower oil prices, we expect it to rise in 2H15 on the back of the strong domestic demand, thanks to lower interest rates and a strengthening domestic currency, with the latter also propelling non-energy imports that account for around 80% of total imports. Consequently, the jump in domestic demand may well tip the total CAD to above its 2014 level.

- **The oil dividend should offer a buffer against Turkey's perceived external fragility.** Nevertheless, the "lower oil theme" should still represent a buffer against Turkey's external fragility against a rising USD, which creates a window of opportunity for continued outperformance until cyclical growth momentum kicks in and/or until structural reforms are in place.

- **A 10% decline in oil prices would lower the rate of CPI inflation by 0.5pps.** The energy related sub-components in the transportation sector (petrol, diesel, LPG) has a 5pp weighting in the CPI basket. However, the secondary effects on inflation may be limited due to the inelastic nature of prices. Due to the automatic pricing mechanism, the impact of the bulk of the recent decline in oil prices should be seen in 2014 inflation readings. Moreover, the oil price plunge also provides us with comfort about our 2015 CPI forecast of 6.5%.

- **A lower oil price would also further strengthen the contribution of domestic demand to 2015 growth.** We have been expecting a revival in domestic demand in 2H15 after a lagged impact from the expected rate cuts, but a lower oil price could pull forward this resuscitation towards 1H15; hence we may raise our 3.4% GDP growth forecast for 2015 to around 4.0%, if we receive further signals on this front in the economic leading indicators, while the income effect and improving confidence on a lower energy bill could also be supportive.

- **The supply overhang in oil is likely to remain in place, supporting Turkey's investment theme as a major importer.** No cut from OPEC and large build up in 1H15 inventories offer us comfort for the prospect of a large oil market surplus in 1H15 and anchor a bearish outlook for oil prices; hence we do not expect a permanent rebound in oil prices to 1H14 levels - a boon for Turkey. The supply overhang is expected to continue not only in the short term, but in the longer run too, as the expectation that incremental supply is waiting in the wings should keep a lid on long-term prices.

- **With the US shale boom, oil producers are concentrating on market share rather than the oil price in an environment of supply overhang, now that there are more competitors ready to supply clients cut off by OPEC. Without a material shift in projected demand or supply, we would expect oil prices to slide further towards $65/bbl over the coming weeks as further price declines will be needed before OPEC members blink and implement moderate production cuts as a slowdown in US production growth becomes apparent.** Below these levels, cyclical forces and the marginal cost of production may possibly create a firmer floor. The next OPEC meeting is scheduled for June 5, 2015, but they have held extraordinary meetings when needed. The alternative is an adjustment by non-OPEC producers – something that would likely require prices to fall even further but over a much prolonged period of time (i.e. several quarters.)

What are the challenges and risks?

- **Main risks:** a return of Eurozone worries with the re-emergence of Euro area political tensions, geopolitical tail events, divergence in policy between the G4 central banks or a sharper downward shock from China's housing and credit imbalances would be the key risk factors, although we would expect the relative value proposition of the Turkish market to remain fairly resilient.

- **Vulnerability to Fed exit:** Turkey remains one of most sensitive EM economies to any tightening in global liquidity conditions and a stronger dollar, but we expect a gradual exit by the Fed with some occasional stop-and-go, which should be a fairly manageable challenge as we will explain later in this report.

- **Sub-trend growth, as in other parts of the world…** Domestic demand has softened with 2014 GDP growth likely to materialize at around 3.0%. While domestic demand should pick up in 2015, especially in the second half of the year, external demand is likely to remain lacklustre, leading to a sub-trend annual growth rate of still below 4.0%, while lower oil prices present an upside challenge to this projection.

- **No support for GDP growth from exports in 2015.** The contribution from net exports to GDP is likely to turn negative in 2015, since we expect a real appreciation of the TRY and higher real loan growth in the banking sector. Geopolitical unrest in the Middle East has recently taken a toll on exports to Iraq and transit trade with the Gulf States, although this has been offset by a rise in exports to Europe - albeit to a feeble extent due to weakness of growth in the continent. Some of Turkey's important export markets (e.g. Russia, Gulf countries) are largely dependent on oil production; thus Turkish exports to these countries could also decline as a result. A silver lining here is that Turkey's export exposure to G3 + China accounts for a mere 8% of GDP, one of the lowest among EMs and around half of the EM average.

- **With consumption outpacing increases in the economy's production capacity (supply), the current account deficit (CAD) remains Turkey's Achilles heel**, hence leaving the TRY fragile to global risk off periods.

    - Continuing robust private credit growth, at 15% YoY, has been boosting consumption rather than investment, with no growth in private capital spending mainly due to exchange rate uncertainty in the real sector, which has a short FX position of US$179bn (as of the end of August) - not inconsiderable, by any means.

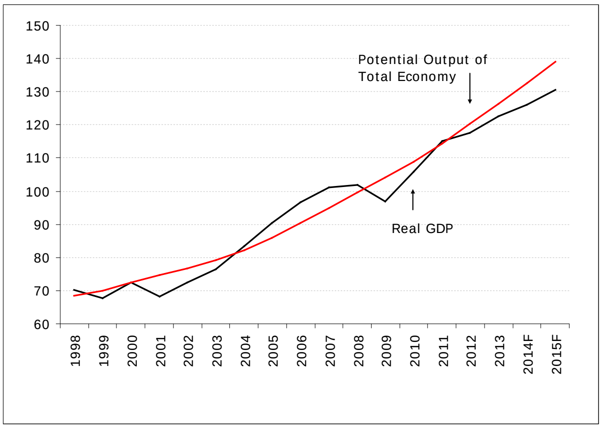
    - While Turkey's CAD is narrowing, it still exceeds 5% of GDP and continues to be financed by shorter-term flows - a concern in the face of the risk of a sudden stop of capital flows, leaving the economy vulnerable to tighter global liquidity conditions. The CAD is likely to bottom out in mid-2015 but rise yet again in 2H15, in line with recovery in domestic demand.

- **Turkey needs to promote savings and structural reform in order to alleviate external fragilities…** Turkey's economic model, which depends heavily on domestic demand, can no longer generate sustainable growth. In times of high banking sector loan growth and strong domestic demand, Turkish GDP may easily exceed its potential output boundary, precipitating demand pull inflation. A rising CAD then raises vulnerability to external shocks, triggering weakness in the lira and precipitating cost-push inflation (through the pass-through effect) and a subsequent slowdown in the economy. This vicious cycle leads to mini boom-bust cycles in Turkey, although policymakers have been managing this conundrum much more prudently over the past decade than in the 1990s.

- **Turkey should therefore shift to an export-led growth model with investments in production financed primarily through domestic savings.** Turkey's economic growth will still have to be maintained at a controlled level until the potential output boundary is shifted through structural reforms to increase productivity, labour force participation and private investment, so as to escape the middle-income trap. The government has already set out details of nine of the 25 structural reforms areas referred to as the Primary Transformation

Program (PTP). The plan aims to shift Turkey's potential output boundary upward in the medium-term and hence reduce its external fragility. The government has placed deadlines on each action plan and mentioned the responsible ministries in order to increase the accountability of the PTP.

Real GDP and Potential Output (TRYbn)



Primary Transformation Program

1 Productivity Growth in Production
2 Reducing Dependence on Imports
3 Increasing Domestic Savings at the National Level
4 Istanbul International Financial Center
5 Rationalization of Public Expenditures
6 Raising the Quality of Public Revenue
7 Improving the Business and Investment Climate
8 Improving the Effectiveness of the Labor Market
9 Reducing the Informal Economy
10 Development of the Statistical Information Infrastructure
11 Commercialization of Priority Technology Areas
12 Technology Development and Local Production through Better Public Procurement
13 Energy Generation Based on Local Resources
14 Energy Efficiency Improvement
15 Effective Use of Water in Agriculture
16 Structural Transformation in Healthcare Industries
17 Improvement in Health Tourism
18 Transition from Transportation to Logistics
19 Development of Basic and Occupational Skills
20 Attracting Qualified Human Resources from Abroad
21 Healthy Life and Mobility
22 Preserving the Family and Dynamic Population Structure
23 Institutional Capacity Development at the Local Level
24 Urban Redevelopment Program to Increase Competitiveness and Social Cohesion
25 Improving International Cooperation Infrastructure for Development

- **The need for fiscal discipline.** Turkey's fiscal policy has been sound with the budget deficit and the public debt/GDP ratio remaining stable, thanks mainly to fiscal discipline and lower interest payments (i.e. declining interest rates and extending borrowing maturity). However, it has been non-tax revenues (such as privatisation receipts) that have saved the day in the wake of falling indirect tax revenues, despite higher non-interest spending. While Turkey's fiscal balance is not a cause for alarm in the near-term, cyclical issues (such as the general election) and structural issues (the need for tax reform) could pose obstacles to further improvement.

- **Geopolitics - something of a wildcard...** There appears a no easy win – win solution for Turkey in the ISIS conflict; hence the government will likely kick the can down the road and remain as "neutral" as it can get away with prior to next June's general election. Turkey is unlikely to mount any unilateral offensive against ISIS, unless its own demands to actively join in the U.S. alliance are met; hence we do not see a major tail risk factor per se, even though the ISIS conflict is likely to remain a key risk and source of volatility, weighing on the Turkish risk premium from time to time. Yet, **it should also be noted that sell-offs due to regional instability have almost always presented a buying opportunity for Turkish assets in the past.**

- **An elephant in the room?...** The Constitutional Court (CC) is expected to decide within two to three weeks on the legality of the 10% election threshold system in Turkey, according to a recent interview with the CC President Hasim Kilic. Opposition parties had applied to the CC to annul the minimum 10% national election threshold needed for a party to be represented with MPs in the parliament. The threshold is higher than the 3-5% levels adopted in many developed countries, and is an obstacle to high public representation in the parliament. The pro-Kurdish party HDP can participate in the general elections with independent members as its voting base hovers around 7-8%, lower than the 10% threshold. If the election threshold were lowered to a level such as 5%, the party would be able to increase its number of seats in parliament, which could lengthen the odds of the AKP being able to rule as a single-party government in a new term, although the chances are it would still manage to achieve the simple majority (276 seats) needed to accomplish this, but by a slim margin. Note, however, that there are good reasons not to take into account these scenarios as 'given' yet; as there are two potential outcomes that would maintain the status quo in the 2015 general elections:

  (i) The CC may rule that the threshold is not an abuse of right, just like the European Court of Human Rights had ruled back in 2007 regarding the very same claim about the election threshold in Turkey.
  (ii) The CC cannot dictate a new threshold nor a deadline to revise the old one, even if it does annul the 10% threshold; it may only ask parliament to determine a reasonable threshold. It is still possible in this case that the parties represented in parliament fail to agree on a new threshold to be put into effect prior to the June 2015 election.

Global backdrop still supportive, despite potential for bouts of volatility

Turkey is a key beneficiary of the "lower-rates-for-longer" theme… The prospects of quantitative expansion from the ECB and expectations of range-bound UST yields in the near term suggest that Turkish bonds will continue to deliver at least the carry, helped by the still-subdued volatility. Any dollar strength is likely to come under a degree of restraint, or develop in a slow and orderly fashion due to the feedback loop of a strong USD impacting policy through disinflation.

Provided there is no bubble, stock markets around the world would benefit from renewed monetary easing, irrespective of any corrective / cyclical bear interruptions, in our view. Although the Fed may realign market expectations in a bid to dampen concerns over financial stability, rates are set to remain extremely low for the foreseeable future. Hence, any near-term sell-off would likely be a temporary setback as the next tightening cycle will be extremely gradual against a fragile economy and lingering global disinflationary pressures. Historically, a restrictive monetary policy would be required to trigger a bear market - and that is a long way off.

Importantly, past experience has amply demonstrated that anaemic economic growth does not necessarily usher in a weak stock market. The crucial point is whether the policy environment, the prospects for growth in profits and the level of interest rates grow more conducive to asset price inflation on the margins. In the absence of a major shock from the left field, we reckon equities will continue to be supported by a powerful combination of low rates and earnings optimism, creating an ideal set up for investor exuberance and potential valuation overshoots.

A recurring feature of this year has been the flattening of yield curves in the US and elsewhere. Front-end yields have been rising in expectation of rate hikes and the longer ends of the curves have been falling in anticipation of the tightening effect of these hikes. This reflects the doubt in the fixed income market that economies are ready for a tightening in monetary conditions and their conviction that if such a tightening was implemented, the economies would suffer.

While monetary policy remains loose or becomes looser, short-term interest rates will stay low - keeping long-term yields under downward pressure - and keep more money flowing to the bond markets. Should monetary policy become tighter, the risk of falling asset prices and slower growth will feed fear of increased deflationary pressures. This will cap real yields at low levels, while more investors will look for safety in the main sovereign bond markets.

In this backdrop, equilibrium long-term bond yields will only edge modestly higher in the next five years, in our view, due to the muted impact of the end of QE programs, reflecting the small extent of the flow effect on yields, as well as the fact that the stock of assets only erodes gradually relative to GDP.

We expect a gradual rise in the fed funds rate to a terminal value of 3.00% or lower in this cycle. We also expect the UST 10Y yield to average slightly higher than 3.00% over the next three years, which can be compared with the 4.50% average UST 10Y yield in the 2004 – 2007 period (during the latest tightening cycle of the Fed), a level that we would not expect to see again for the rest of this decade, providing a relative carry advantage for the spread product.

During the last period of US policy normalization, the fed funds rate rose from 1% in mid-2004 to 5.25% in mid-2006, while EM equities (including Turkish stocks) enjoyed a powerful bull market extending from 2003 to 2007. EM financial systems are also not as fragile as often feared considering the rate hike cycles in the 1990's. The banking system proved resilient in 2H13 when stress tested with large net redemptions in EM bond funds. The widely-feared credit crunch did not materialize. The fall in EM currencies last year proved painful for investors - but exchange rate flexibility has served as a shock absorber, facilitating a reduction in the current account deficit.

In the past seven major US dollar rallies since 2003, which lasted an average of 191 days and 452 days at most, the Dollar Index (DXY) rose by an average of 14% (and a maximum of 23%). The latest DXY rally started 206 days ago, and the DXY has so far risen by 12% in this cycle, with a gentler slope than in past cycles, having increased by an average of 0.05% a day, compared to an average of 0.09% a day in the past.

Previous DXY rallies have exhibited some common characteristics:

(i) the USD/TRY exchange rate has not risen as much as the DXY (which is again the case in the current cycle, as the USD/TRY is up by 6%, in contrast with the 12% increase in the DXY);
(ii) the BIST-100 index is down by an average of 10% in USD terms (up 8.5% in the current cycle);
(iii) US yield curves have flattened, as expected, while long-end UST yields have been fairly flat, despite the increase in short-end rates, which has helped Turkish bond yields ease in four of the past seven cycles; (The 2Y UST yield rose by 7bps, while the 10Y UST yield fell by 39bps in the current cycle, while the Turkish 2Y government bond yield eased by 172bps);
(iv) the Fed was flat in five of the seven DXY rallies and on an easing bias in one of them, while the CBRT was cutting in five and flat in one of the rallies, with only one hiking cycle by both banks.

DXY rallies usually coincide with flat long-ends in the US and easing cycles / lower yields in Turkey

DXY Rally Cycles since 2003		Number of Days	DXY (% chg.)	USD/TRY (% chg.)	BIST100 (USD) (% chg.)	2Y TR local bond yield (chg. in bps)	2Y UST yield (chg. in bps)	10Y UST yield (chg. in bps)
Jun-03	Aug-03	72	7%	-1%	7%	-909	81	136
Feb-04	May-04	86	8%	17%	-25%	576	99	81
Dec-04	Nov-05	324	14%	0%	42%	-671	134	17
Jul-08	Nov-08	129	23%	38%	-55%	29	-127	-62
Dec-08	Mar-09	78	13%	13%	-24%	-266	14	62
Nov-09	Jun-10	194	19%	7%	11%	5	-3	-13
Apr-11	Jul-12	452	15%	20%	-26%	-36	-39	-190
May-14	Present	206	12%	6%	9%	-172	7	-39
Average of past cycles		**191**	**14%**	**13%**	**-10%**	**-182**	**23**	**5**
Average (daily standardised)			**0.09%**	**0.09%**	**-0.16%**	**-1.6**	**0.3**	**0.4**
Current cycle		**206**	**12%**	**6%**	**9%**	**-172**	**7**	**-39**
Current cycle (daily standardised)			**0.05%**	**0.03%**	**0.04%**	**-0.8**	**0.0**	**-0.2**

Source: Ak Investment

The dollar has the potential to alter the course of Fed policy in the current cycle. The tightening in monetary conditions has almost always occurred as a result of higher interest rates in the US. The USD has tended to be flat - or fall - in almost every Fed tightening cycle since 1990. The FOMC might be almost a year away from the next rate hike cycle, but the dollar’s 7% appreciation in trade-weighted terms since the beginning of the year has already tightened monetary conditions by about 70bps. In other words, the dollar’s rise has the same effect on the economy as a 70bps Fed rate hike. The bond market indeed serves as a key relief valve in offsetting the deflationary impact of a strong dollar, and if the dollar is in a bull market, it usually supports bonds and keeps monetary tightening at bay, especially in times of sub-trend growth.

A key task facing the Fed is to guide the markets into a pricing scheme whereby an actual tightening would cause little market reaction. As such, the Fed clearly wants to avoid forming bubbles; hence, its balancing act would be to reduce any froth in asset markets by increasing risk premia while avoiding the impression that a policy error is in train. The Fed can soon remove the “considerable time” phrase in an otherwise dovish FOMC statement to engender some volatility. Rates could go up and equities could go down. The Fed could square the circle, on the other hand, by delaying rate hikes into 2016 by “failing” to meet (i.e. rolling forward) the 2015 “dots” rather than pre-announcing a delay, buying time for productivity relief and a more robust profits picture. This would re-compress risk premia, with rates adjusting downward, and equities going up. Carry trades would prosper at the front end, as actual market rates converge with the current market expectations rather than the FOMC’s current guidance path.

The ECB's move towards QE should also help maintain a basically friendly fixed income backdrop globally, even as rates in core markets gradually rise over the coming years. China and Japan also need to remain accommodative against this backdrop. The eagerness of the ECB and other core central banks to do more in the future should help soothe Fed-related worries in the context of Turkey’s external finances. Historically, an expansion in the ECB balance sheet relative to the Fed has been a leading indicator for TRY appreciation in trade-weighted (NEER) terms.

We are reluctant to give up the carry at a time when the ECB has promised to expand its balance sheet. Bond yields in Europe are likely to match Japanese levels when the ECB announces a large-scale asset purchase (LSAP) program. We envisage the LSAP exerting more downward pressure on European interest rates than the Fed's QE has exerted on US rates, because of the negative deposit rates in the Eurozone. When the ECB buys bonds from banks, banks will be looking to use those funds immediately, to avoid the penalty interest rates on deposit accounts held at the ECB. We would not expect any significant pick up in credit activity; hence many banks will either park the surplus money in bonds, virtually irrespective of the yield, or lend the money outside the Eurozone. Even though ECB purchases may or may not include peripheral sovereign debt, all spread products will benefit from the withdrawal of duration from the Eurozone bond market.

To the extent that the ECB succeeds in bringing the euro lower, the Eurozone's already massive C/A surplus is likely to grow and hence channel European flows into other higher-yielding country assets, such as those of 'good' EMs, while giving rise to lower long-end yields and exceptionally flat global yield curves. If the ECB is unable to expand its balance sheet sufficiently to weaken the euro on the margins, inflation expectations may again continue to fall, further pressurising core yields downward, which is also likely to be an incremental positive for flows into EMs, thanks to the carry on offer, despite a potential interim Eurozone deflation "fear trade".

Financials still offering a better PEG outlook

We expect 13.4% EPS growth for our BIST coverage in 2015. Thanks mainly to the NIM recovery, banks, with 18.9% EPS growth, will fare better than the non-financials (expected 9.1% EPS growth). This would be a mirror image of 2014, when non-financials will have posted stronger results, thanks largely to recovering FX losses.

With a 2015F P/E of 8.7x, financials also appear more attractively-valued than non-financials, which are trading at an aggregate 2015F P/E of 12.3x.

	Earnings Growth		P/E		EV/EBITDA	
	2014F	2015F	2014F	2015F	2014F	2015F
Industrials*	44.1%	8.6%	13.8	12.7	9.2	7.7
Conglomerates*	-0.8%	10.2%	12.6	11.5	20.0	16.6
Non-Financials Total	26.4%	9.1%	13.4	12.3	12.6	10.5
Banks*	-5.9%	18.9%	10.4	8.7		
Insurance	-28.9%	26.0%	15.2	12.1		
Real Estate	-1.9%	32.5%	10.3	7.7		
Financials Total	-6.0%	20.3%	10.4	8.7		
Total Coverage	11.3%	13.4%	12.27	10.55		

*adjusted for one off items in AEFES, CCOLA, ANACM, TRKCM, SISE, VAKBN, HALKB

Updated target prices of the stocks under our coverage, with respective notes from our analysts on each company, are provided in the following pages of this report.

Along with this report, we are also making a number of rating changes, notes on which follow in subsequent pages.

Upgrades to:

Outperform: Halkbank, Vakifbank, Yapi Kredi Bank, Torunlar REIC
Neutral: Anadolu Efes, Sekerbank

Downgrades to:

Neutral: Albaraka Turk, TSKB, Banvit
Underperform: TAV Airports

Coverage Updates

Target price revisions in our coverage

BANKS

Company	Ticker	Current Price	12m Target Price Old	12m Target Price New	upside	Rating	Rating action	Comment
Albaraka Turk	**ALBRK**	1.78	1.90	2.10	18%	Neutral	↓	After a strong share price performance in the last two weeks, we have downgraded our rating for Albaraka Turk to 'Neutral' because of the bank's relatively low utilization of falling interest rates when compared to conventional depository banks.
Garanti Bank	**GARAN**	9.77	9.30	10.80	11%	Neutral	↔	We welcome BBVA's decision to keep Garanti's chairman and CEO in place for some time in order to sustain Garanti's enviable strategy. Yet, with just 11% upside, we maintain our 'Neutral' rating.
Halkbank	**HALKB**	15.80	15.90	18.50	17%	Outperform	↑	The negative sentiment associated with the classification of a sizeable big ticket loan as an NPL in 3Q14 has been overdone given Halkbank's NIM advantage in a falling interest rate environment while the sale of its insurance company remains another near term catalyst.
Isbank	**ISCTR**	6.16	6.20	7.30	19%	Outperform	↔	Isbank remains one of our picks with its attractive valuation and strong earnings catalyst, especially in the first half of 2015 due to seasonality of dividend income.
Sekerbank	**SKBNK**	1.95	2.00	2.20	13%	Neutral	↑	We have upgraded our rating for Sekerbank from 'Underperform' to 'Neutral'. The Bank has underperformed the banking index by 23% so far this year, and now offers 13% upside.
TSKB	**TSKB**	2.01	2.30	2.40	19%	Neutral	↓	We downgrade our rating for TSKB to 'Neutral'. Our call is primarily based on the bank's relatively defensive share performance during a bullish cycle.
Vakifbank	**VAKBN**	5.10	4.80	6.10	20%	Outperform	↑	Vakifbank is a beneficiary of the easing rate cycle and may also bring upside to its bottom-line if its relatively high NPL coverage is brought down towards the sector average.
Yapi Kredi Bank	**YKBNK**	5.32	4.90	6.30	18%	Outperform	↑	We have upgraded our rating for Yapi Kredi to 'Outperform' on the back of its attractive growth plans, barring a major growth-related asset quality risk, which we do not deem likely.

INSURANCE

Company	Ticker	Current Price	Target Price Old	Target Price New	upside	Rating	Rating action	Comment
Aksigorta	**AKGRT**	2.66	3.50	3.70	39%	Outperform	↔	A slight upward revision in our 12-month TP on a lower CoE.
Anadolu Hayat	**ANHYT**	4.78	6.08	6.44	35%	Outperform	↔	A slight upward revision in our 12-month TP on a lower CoE.

AKInvestment

REICs								
Company	Ticker	Current Price	Target Price Old	Target Price New	upside	Rating	Rating action	Comment
Emlak REIC	**EKGYO**	2.82	3.40	3.65	29%	Outperform	↔	We have made an upward adjustment to pre-sales assumptions, supported by improving macro environment in 2015 and a lower CoE.
IS REIC	**ISGYO**	1.37	1.80	1.90	39%	Outperform	↔	A slight upward revision in our 12-month TP on a lower CoE.
Sinpas REIC	**SNGYO**	0.84	1.16	1.20	43%	Outperform	↔	A slight upward revision in our 12-month TP on lower CoE.
Torunlar REIC	**TRGYO**	3.61	4.00	4.30	19%	Outperform	↑	A slight upward revision in our 12-month TP on lower CoE.

NON-FINANCIALS								
Company	Ticker	Current Price	Target Price Old	Target Price New	upside	Rating	Rating action	Comment
Adana Cimento	**ADANA**	5.46	5.00	6.00	10%	Neutral	↔	We have made an upward adjustment to our EBITDA margin forecasts on favourable pricing and a bright demand outlook, along with a lower CoE.
Anadolu Efes	**AEFES**	25.40	27.00	28.60	13%	Neutral	↑	Higher 12-month TP with lower CoE, and revised forecasts following positive 3Q14 surprise in Turkey beer volumes, despite negative impact from the downward revision in CCI's valuation.
Akcansa	**AKCNS**	14.40	16.50	17.10	19%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Akenerji	**AKENR**	1.36	1.20	1.25	-8%	Underperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Akfen Holding	**AKFEN**	4.79	6.20	6.38	33%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Aksa	**AKSA**	7.47	8.00	8.51	14%	Neutral	↔	We have made some adjustments to our forecasts, raising the 2014F EBITDA margin from 12.5% to 14.8% and 2015F margin from 13.0% to 15.1% on lower costs thanks to falling oil prices. This is on top of the lower CoE.

NON-FINANCIALS								
		Current	Target Price				Rating	
Company	Ticker	Price	Old	New	upside	Rating	action	Comment
Aksa Enerji	**AKSEN**	3.10	3.48	3.68	19%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Alarko Holding	**ALARK**	4.10	4.48	4.65	13%	Neutral	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Anadolu Cam	**ANACM**	1.93	2.28	2.30	19%	Neutral	↔	The positive impact of a lower CoE assumption on the 12-month TP was offset by a more cautious approach in forecasts regarding the Russian operations on a weaker Ruble.
AnelElektrik	**ANELE**	1.33	1.60	1.68	26%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Arcelik	**ARCLK**	14.20	14.50	15.10	6%	Neutral	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Aselsan	**ASELS**	11.05	12.10	13.20	19%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Banvit	**BANVT**	2.99	3.50	3.40	14%	Neutral	↓	Downward revision in forecasts following disappointing 3Q14 results.
Bim	**BIMAS**	49.40	48.00	50.00	1%	Underperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Bimeks	**BMEKS**	1.88	2.42	2.48	32%	Outperform	↔	Slight upward revision in our 12-month TP on lower CoE.
Bizim Toptan	**BIZIM**	19.15	23.80	23.70	24%	Outperform	↔	Some revisions to 2015 forecasts on the back of a lower CoE.
Coca Cola Icecek	**CCOLA**	49.90	59.80	57.70	16%	Neutral	↔	The positive impact of lower CoE assumption on 12-month TP more than offset by more cautious approach to forecasts following 3Q14 realizations and lowered management guidance
Cimsa	**CIMSA**	15.75	18.60	19.00	21%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.

NON-FINANCIALS								
			Target Price					
Company	Ticker	Current Price	Old	New	upside	Rating	Rating action	Comment
Enka	ENKAI	5.77	7.10	7.41	28%	Outperform	↔	Downward revision in 2015 forecasts due to the change in plans regarding Kuntsevo project (Russia) and lower occupancy rate in retail and office areas in Russia - but higher 12-month TP on lower CoE.
Erdemir	EREGL	4.51	4.90	5.17	15%	Neutral	↔	As well as a lower CoE, we have also made an upward adjustment to EBITDA margin forecasts given favourable spreads. 2014 EBITDA margin forecast raised from 17.9% to 21.3%, and from 18.1% to 20.3% for 2015.
Hurriyet	HURGZ	0.80	0.45	0.61	-24%	Underperform	↔	Some revisions to our forecasts, lowering capex to sales from 6% to 3% for 2015 onwards, as well as lower CoE.
Indeks Bilg.	INDES	5.74	6.50	6.95	21%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Kardemir	KRDMD	2.13	2.80	2.90	36%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Migros	MGROS	22.75	24.00	26.00	14%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Pegasus	PGSUS	32.40	35.00	38.00	17%	Outperform	↔	Higher 12-month TP with lower CoE and lower oil price assumption.
Royal	ROYAL	2.74	3.23	3.23	18%	Neutral	↔	Target price incorporates low predictability after the negative 3Q14 surprise.
Sabanci Holding	SAHOL	10.60	12.60	13.90	31%	Not Rated	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Selcuk Ecza	SELEC	2.06	2.30	2.10	2%	Underperform	↔	Downward revision in forecasts, due to disappointing 3Q14 results.
Sise Cam	SISE	3.53	3.65	3.90	10%	Neutral	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
TAV Airports	TAVHL	19.00	18.80	19.10	1%	Underperform	↓	Positive impact of a lower CoE assumption on 12-month TP was off-set by expectation of a weaker EUR.

NON-FINANCIALS								
Company	Ticker	Current Price	Target Price Old	Target Price New	upside	Rating	Rating action	Comment
Turkcell	**TCELL**	14.05	13.90	15.52	10%	Neutral	↔	12-month TP adjustment on improved expectations for operating performance in the forecast period, improved macroeconomic outlook and lower CoE.
Turkish Airlines	**THYAO**	9.21	8.40	9.96	8%	Neutral	↔	Higher 12-month TP with lower CoE and lower oil price assumption
Tekfen Holding	**TKFEN**	6.03	7.26	7.82	30%	Outperform	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.
Teknosa	**TKNSA**	8.94	12.00	11.95	34%	Outperform	↔	We have lowered our forecasts for Teknosa, lowering our 2014F EBITDA margin from 3.3% to 2.9% and our 2015F EBITDA margin from 4.4% to 3.8%. Our 12-month TP therefore falls slightly, despite the lower CoE.
Trakya Cam	**TRKCM**	3.18	3.41	3.80	19%	Outperform	↔	Higher 12-month TP with lower CoE.
Türk Telekom	**TTKOM**	7.10	7.65	8.06	14%	Neutral	↔	12-month TP adjustment on some downward revisions to forecasts and lower CoE.
Tupras	**TUPRS**	50.10	54.00	56.20	12%	Neutral	↔	Downward revision in 2014 estimates due to higher inventory loss expectation. Higher 12-month TP with lower CoE.
Ulker	**ULKER**	16.70	18.00	18.50	11%	Neutral	↔	12-month TP adjustment on fine tuning of forecasts, improved macroeconomic outlook and lower CoE.

Rating Changes

Banks

Halkbank			Price:	15.80
Outperform - upgraded			12M Target:	18.50

We believe the negative sentiment associated with the classification of a sizeable big ticket loan as an NPL in 3Q14 has been overdone given Halkbank's NIM advantage under a falling interest rate environment. We have raised our 12-month price target for Halkbank by 16% to TRY18.50, finding 17% upside, while upgrading our rating to 'Outperform'.

One possible catalyst could be the sale of the insurance and pension fund assets at a premium. Bullish news flow on Turkey's oil trade (due to its role as a financial intermediary in the region) is amongst the other catalysts.

In terms of risks, the failure to sell the insurance company may be a concern. Again, Halkbank's high foreign ownership ratio is also eye catching; such positioning could represent a drawback for the share price if there is a sell-off in global equities.

Forecasts (TRYmn)	2012	2013	2014F	2015F
T. Assets	108,282	139,944	154,406	175,508
Sh. Equity	12,323	14,146	16,404	18,783
T. Loans	65,551	84,413	98,882	117,954
Net Profit	2,595	2,751	2,320	3,300
RoE	24.8	21.1	15.3	18.7
P/B	1.7	1.4	1.2	1.1
P/E	7.7	7.2	8.5	8.2

Vakifbank			Price:	5.10
Outperform - upgraded			12M Target:	6.10

After increasing our profit forecasts for the bank by 25% for 2015 and 7% for 2016, we raise our 12 month price target by 27% to TRY6.10, finding 20% upside and raise our rating to 'Outperform'.

With one of the widest maturity gaps and relying heavily on TRY assets, Vakifbank is a major beneficiary of the easing cycle. Additionally, the management's recent decision to divest its Visa and Mastercard shares (held in its available-for-sale portfolio) is likely to give a boost of around TRY250mn – 300mn to the bottom line and improve its Tier-1 ratio by 20bps – 25bps.

Finally, the Bank seems to have outperformed the BIST-100 index by 5% and yet still underperformed the banking sector index by 1.0% on a YtD basis.

Forecasts (TRYmn)	2012	2013	2014F	2015F
T. Assets	104,580	135,496	151,394	171,561
Sh. Equity	11,918	12,616	14,461	16,334
T. Loans	67,868	86,496	101,190	117,888
Net Profit	1,460	1,586	1,500	2,000
RoE	13.9	13.0	11.2	12.9
P/B	1.1	1.0	0.9	0.8
P/E	8.7	8.0	8.5	7.3

Yapi Kredi			Price:	5.32
Outperform - upgraded			12M Target:	6.30

With the market welcoming the bank's faster than average growth, Yapi Kredi has outperformed the banking index by 6% and the BIST-100 by 12.5% so far this year. We have upgraded our rating for Yapi Kredi to 'Outperform' on the back of its attractive growth plans, barring a major growth-related asset quality risk, which we do not deem likely. After raising our 12-month price target by 29% to TRY6.30 per share, Yapi Kredi shares now offer 18% upside.

If the management falls significantly short of its growth targets, we may see a sell-off. Yapi Kredi has the lowest NPL coverage among the listed large cap private banks, at 73% (the same as the sector average) and could therefore feel more provisioning pressure if a severe deterioration in asset quality were to hit. Finally, regulations on fees and commissions will hit the bank relatively hard, because of its larger credit card franchise.

Forecasts (TRYmn)	2012	2013	2014F	2015F
T. Assets	122,180	148,881	172,507	198,806
Sh. Equity	16,862	17,309	19,338	21,453
T. Loans	74,795	94,891	114,503	136,206
Net Profit	1,913	3,203	1,850	2,300
RoE	13.8	18.7	10.2	11.3
P/B	1.6	1.63	1.4	1.2
P/E	12.1	11.4	12.5	10.1

Sekerbank

Neutral - upgraded

Price:	1.95
12M Target:	2.20

We have upgraded our rating for Sekerbank from 'Underperform' to 'Neutral'. The Bank has underperformed the banking index by 23% so far this year, and now offers 13% upside with our revised 12-month price target of TRY2.20/share. Rather than fundamentals, acquisition expectations may continue to set the stage for a highly volatile path for Sekerbank shares going forward.

We had reiterated our 'Underperform' call after the disappointing 3Q14 net profit of TL30.4mn, compared to the consensus estimate of TL54mn. Largely as a result of the elevated loan loss provisioning and sharp contraction of more than 100bps YoY in the bank's adjusted NIM, Sekerbank's cumulative net profit in 9M14 was also down 20% YoY, weakening the prospects that the bank would reach the TL175mn in net income as guided by the bank for 2014.

Forecasts (TRYmn)	**2012**	**2013**	**2014F**	**2015F**
T. Assets	14,518	18,725	21,158	24,138
Sh. Equity	1,825	2,055	2,362	2,582
T. Loans	9,928	13,222	14,595	16,929
Net Profit	240	210	155	220
RoE	14.7	10.9	7.1	8.9
P/B	1.3	1.3	1.0	0.9
P/E	8.8	10.1	13.7	9.6

Albaraka Turk

Neutral - downgraded

Price:	1.78
12M Target:	2.10

After a strong share price performance in the last two weeks, we downgrade our rating for Albaraka Turk to 'Neutral' and remove it from our "most-preferred stocks" list because of the bank's relatively low utilization of falling interest rates when compared to conventional depository banks. However, we have raised our 12-month target price by 11% to TRY2.10/share, finding 18% upside. Albaraka Turk's 2015F P/B of 0.8x and 2015F P/E of 5.3x are still below the sector averages of 1.1x and 8.7x.

We had upgraded our rating for Albaraka Turk to 'Outperform', on our conviction that the share price overstates the potential entry of state banks into participation banking. Since our upgrade Albaraka Turk has outperformed the BIST-100 index by 4%. However, it has underperformed the sector index by 14% so far this year. In our view, this indicates a fair discount which can be associated with the upcoming competition from state banks.

Forecasts (TRYmn)	**2012**	**2013**	**2014F**	**2015F**
T. Assets	12,328	17,217	22,411	25,919
Sh. Equity	1,218	1,497	1,731	2,000
T. Loans	9,075	12,034	15,169	17,904
Net Profit	192	241	250	300
RoE	17.4	18.1	15.6	16.1
P/B	1.4	1.1	0.9	0.8
P/E	8.4	6.6	6.4	5.3

TSKB

Neutral - downgraded

Price:	2.01
12M Target:	2.40

We downgrade our rating for TSKB to 'Neutral'. Our call is primarily based on the bank's relatively defensive share performance during a bullish cycle. Because of the revision in the CoE factor and some adjustments in our future RoE forecasts, we have raised our price target by just 4% to TL2.40 with 19% upside.

We still like TSKB, especially as a safe haven during stormy times; the stock has had a negative correlation with the banking sector index during the up and down cycles in the last two years. So TSKB's FX-weighted long-term funding mix provides strong immunity against TL interest rate volatility.

Forecasts (TRYmn)	**2012**	**2013**	**2014F**	**2015F**
T. Assets	10,290	12,911	15,520	18,049
Sh. Equity	1,755	1,885	2,296	2,636
T. Loans	6,895	9,177	11,325	13,891
Net Profit	307	326	375	415
RoE	20.0	18.1	18.2	17.0
P/B	1.76	1.6	1.3	1.1
P/E	9.8	9.2	8.0	7.3

Non-financials

Anadolu Efes

Neutral - upgraded

Price: 25.40
12M Target: 28.60

We are upgrading our rating for Anadolu Efes. Our new 12-month TP of TRY28.60, derived from the SoTP valuation of Turkey and International beer operations and 50.3% stake in Coca Cola Icecek implies 13% upside potential.

We have reflected the significant improvement in Turkey beer sales, which came in as a positive surprise; there was no YoY contraction in volumes in 3Q14, for the first time in 9 quarters. We now expect the operations to close 2014 with a 4% YoY decline in sales (down 6% as of 9M14) and post slight YoY growth in 2015.

Anadolu Efes shares have underperformed the benchmark index by 14% in the last 2 months, reflecting a series of poor financial results, exposure to the ailing Russian market and a weak outlook. We now think the Turkey beer outlook has improved, which would help repair sentiment.

Forecasts (TRYmn)	2012	2013	2014F	2015F
Net Sales	4,320	6,599	7,065	7,715
EBITDA	890	1,126	1,262	1,444
EBITDA marg.	20.6%	17.1%	17.9%	18.7%
Net Profit	610	213	252	340
EV/Sales	3.4	2.5	2.4	2.2
EV/EBITDA	16.3	14.9	13.5	11.7
P/E	23.1	72.2	59.7	44.2

Banvit

Neutral - downgraded

Price: 2.99
12M Target: 3.40

We downgrade our recommendation for Banvit shares to Neutral, as we think poultry exports to Russia are overly exaggerated by the market. The management only expects a small contribution from Russian exports on both the top-line and profitability in 2014.

In the domestic market, 4Q is seasonally the weakest season for poultry consumption and poultry prices remain weak with the end of the barbecue season after 3Q and the start of the fish season (4Q). We believe most of the positives (improving profitability with better domestic demand - 9.0% EBITDA margin in 4Q14 vs. 5.2% in 2013 - and poultry exports to Russia) have been reflected to the share price.

Forecasts (TRYmn)	2012	2013	2014F	2015F
Net Sales	1,261	1,655	2,003	2,286
EBITDA	83	86	121	160
EBITDA marg.	6.6%	5.2%	6.0%	7.0%
Net Profit	10	-56	5	35
EV/Sales	0.7	0.5	0.4	0.4
EV/EBITDA	10.5	10.2	7.2	5.5
P/E	29.9	n.m.	59.8	8.5

TAV Airports

Underperform - downgraded

Price: 19.00
12M Target: 19.10

We are downgrading our rating for TAV Airports due to the stretched valuation after recent gains and lack of short-term catalysts to further drive the share performance. We think TAV Airports is currently fairly valued with no real upside potential left to our 12-month TP of TRY19.10.

Unlike the airlines, TAV's financials are not directly linked to the falling oil prices. The company is also negatively affected by the weak EUR against the US$ and TRY, given the high weight of the TRY in revenues vs. a cost structure dominated by the US$ and TRY.

The long-awaited new contract to expand the international terminal at the Istanbul Ataturk Airport was officially signed recently without any positive surprises. We think the market has largely priced in the news with the 4% outperformance posted vs. the benchmark index since the announcement.

Forecasts (EURmn)	2012	2013	2014F	2015F
Net Sales	847	904	941	1,010
EBITDA	328	381	420	430
EBITDA marg.	38.7%	42.1%	44.6%	42.5%
Net Profit	129	133	190	209
EV/Sales	3.9	3.7	3.7	3.3
EV/EBITDA	10.1	8.9	8.3	7.7
P/E	19.4	18.9	13.2	12.0

Torunlar REIC

Outperform - upgraded

Price: 3.61

12M Target: 4.30

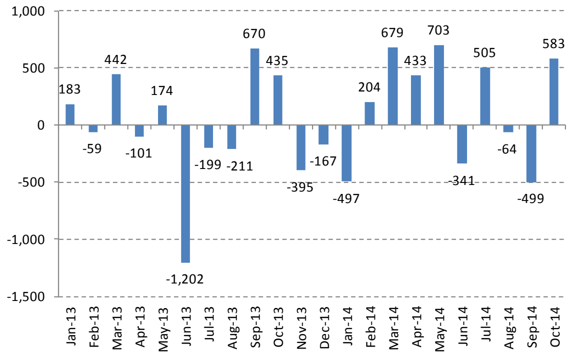
We upgrade our recommendation to Outperform for Torunlar REIC shares, as we think that negatives related to elevator accident at its Torun Center construction has been already priced in (the stock has underperformed the BIST-100 total return index by 11% over the last three months). Note that the suspension ruling for the project was lifted in mid-November.

We believe the fundamentals remain strong since the rental income will continue to grow with the full contribution of Mall of Istanbul and Torun Tower in 4Q14 and into 2015. Besides, the launch of the Kiptas residential project, on which pre-sales are expected to start in early 2015, could also serve a near-term catalyst for the stock, in our view.

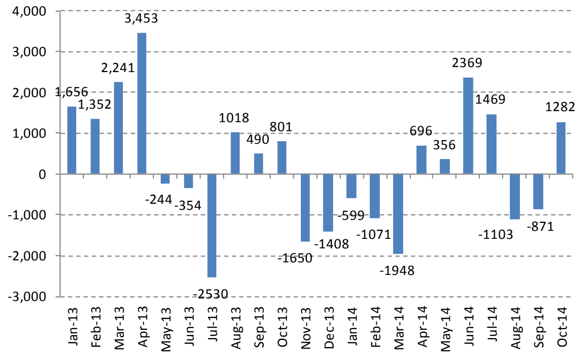
Forecasts (TRYmn)	2012	2013	2014F	2015F
Net Sales	225	344	750	1,150
EBITDA	122	141	325	520
EBITDA marg.	54.3%	40.9%	43.3%	45.2%
Net Profit	337	191	310	500
EV/Sales	15.9	10.4	4.8	3.1
EV/EBITDA	29.2	25.3	11.0	6.9
P/E	5.4	9.5	5.8	3.6

Key charts

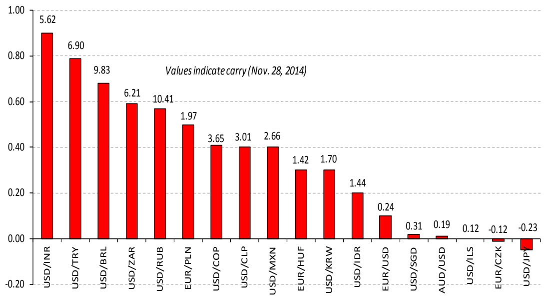
Foreign Flows to the Turkish Equity Market (US$mn)



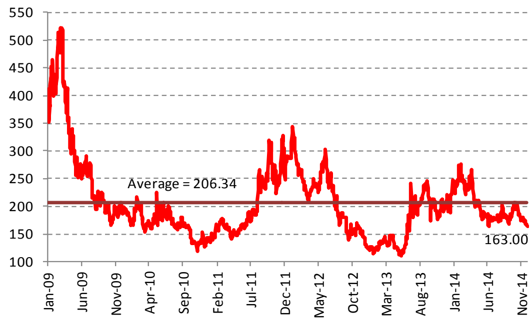
Foreign Flows to the Turkish Govt. Bond Market (US$mn)



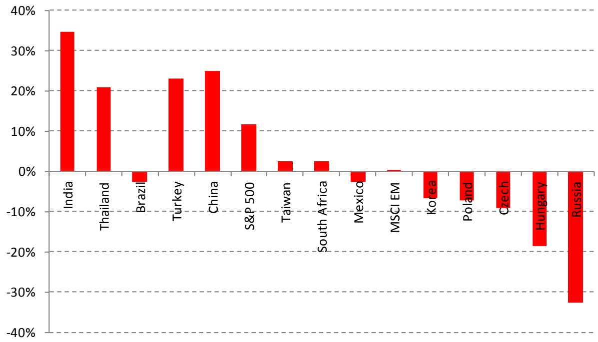
Carry (1m interest differential) / Implied Vol (1m)



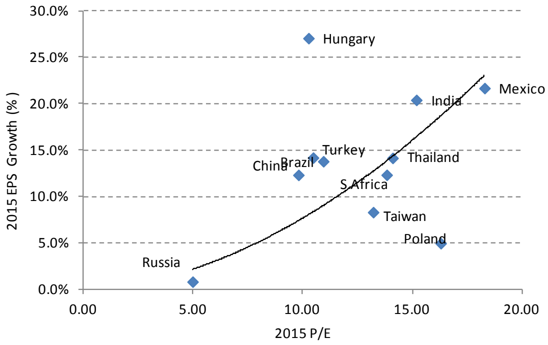
Turkey 5Y CDS



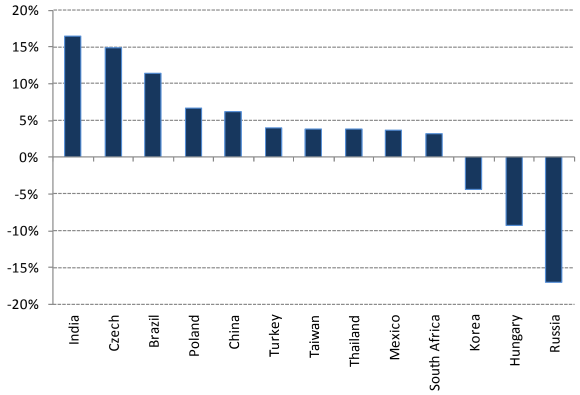
EM Stock Indices Year-to-date Performance (in USD terms)



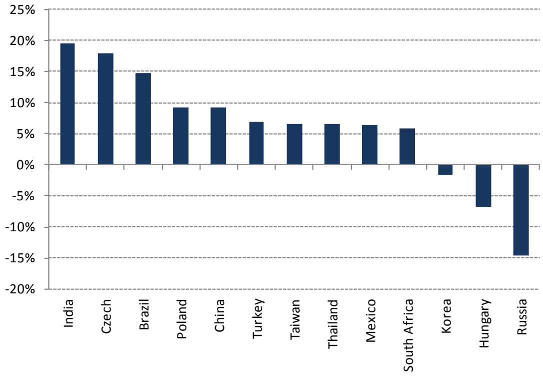
2015 EPS Growth vs. P/E



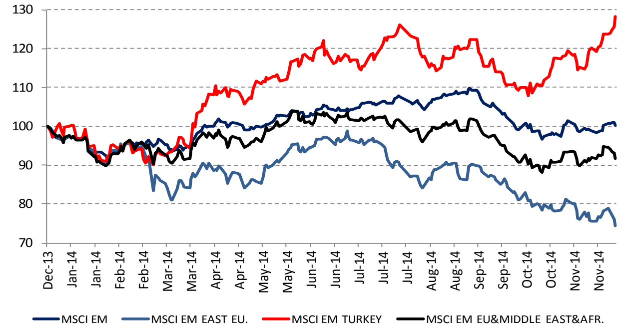
Current P/BV Multiples - Deviation from Hist. 3Y Average



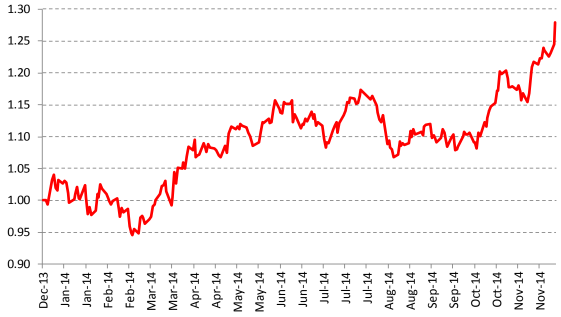
P/BV Multiples rel. to P/BV of MSCI EM (Deviation from Hist. 3Y Avg.)



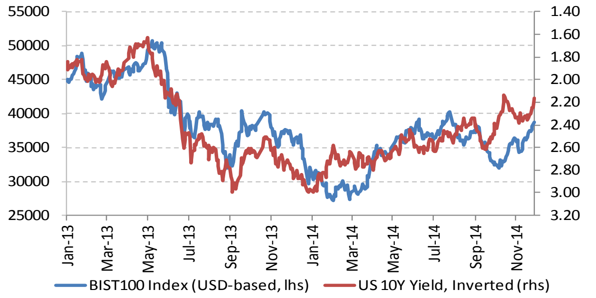
MSCI Turkey Relative to MSCI Peer Indices



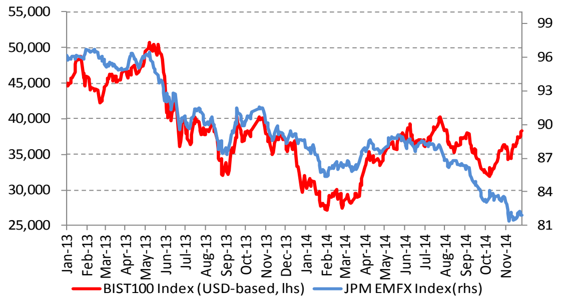
MSCI Turkey Index / MSCI EM Index



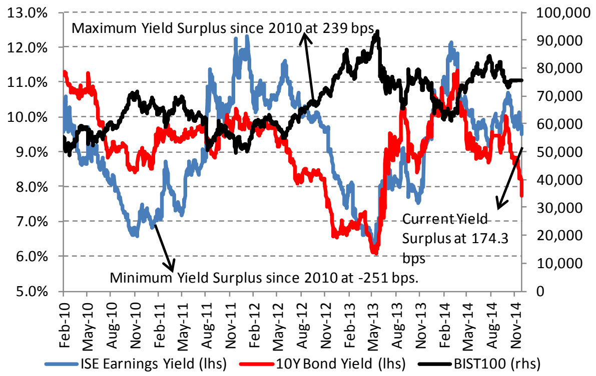
BIST100 Index (USD-based) vs. US 10Y Bond Yield (Inverted - rhs)



BIST100 Index (USD-based) vs. JPM EMFX Index

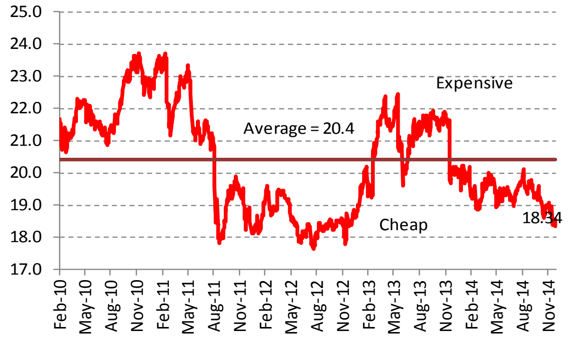


BIST Earnings Yield vs. 10Y Government Bond Yield

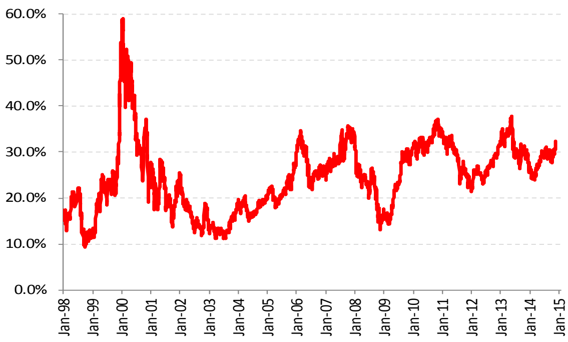


BIST Earnings Yield minus 10Y Government Bond Yield

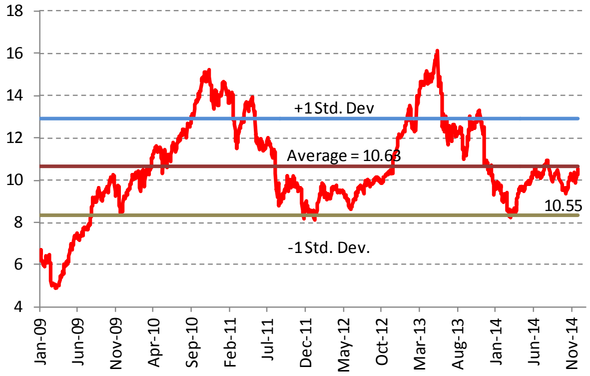
BIST P/E plus 10Y Govt. Bond Yield (absolute value)



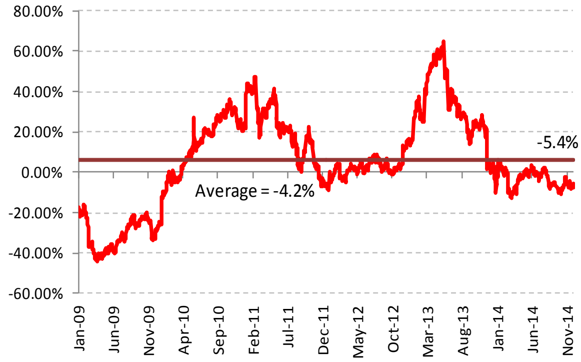
BIST100 - Mcap/GDP



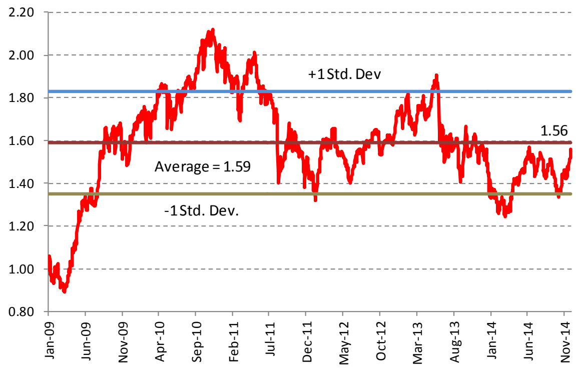
BIST 12-Month Forward-Looking P/E



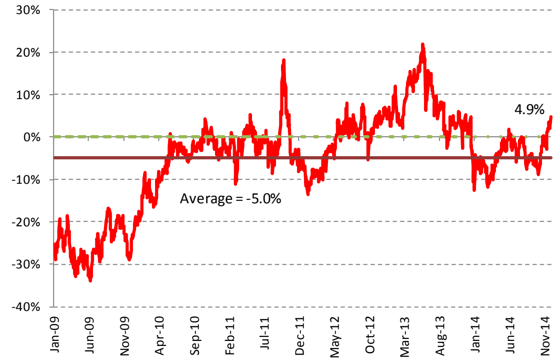
BIST vs. MSCI EM (Premium/Discount of P/E)



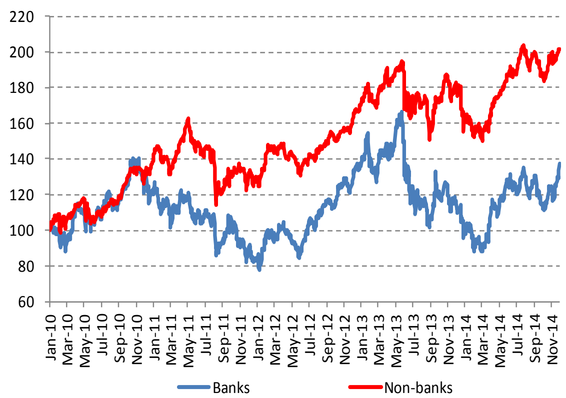
BIST P/BV



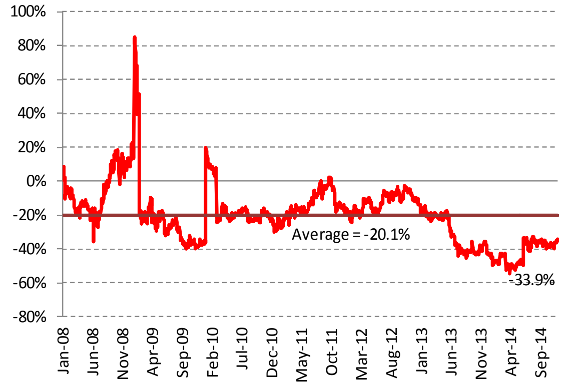
BIST vs. MSCI EM (Premium/Discount of P/BV)



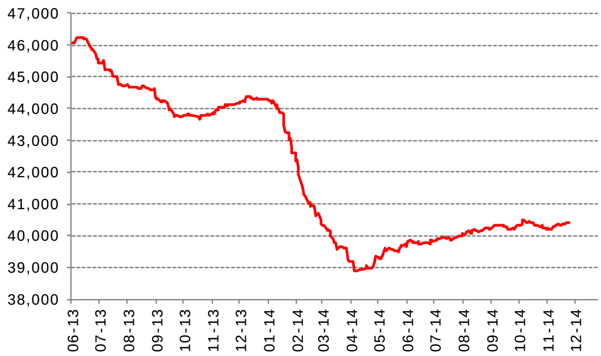
BIST - Banks vs. Non-banks Index Performance



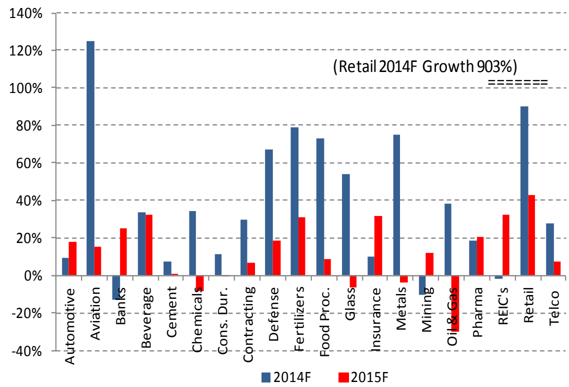
BIST - Banks / Non-banks (Premium/Discount of P/E)



BIST - 2014 Aggregate Net Earnings Forecast (BBERG Consensus, TLmn)



BIST – 2014/2015 EPS Growth by Sectors



Top Stock Ideas

Turkish Equities / Defense/ Company Update

Aselsan

A major military contractor

OUTPERFORM
Current price: TRY11.05
12-mo T.Price: TRY13.20

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Aselsan is a defensive play as no cut-backs in military spending are expected in Turkey or the region. Aselsan trades at a premium to peers, which we find justified given its relatively rapid rate of growth compared to its peers. The majority of financing (advances on orders and R&D funding) is US$ based.

Aggressive growth target for Turkish Defence Industry revenues. Turkey's Defence Industries Undersecretary (DIU) targets a virtual doubling in Turkish defence industry revenues from US$4.3bn in 2011 to US$8.0bn by 2016. Aselsan is one of the largest Turkish Defence companies, with a 20% - 25% share in the domestic sector. We find the DIU's target quite realistic as it points to a 13% CAGR over the period, compared to a historic 5-year CAGR of 19% in revenues for the industry. Turkey is located in a volatile and conflict-prone region. Turkish military spending has always been high and will, most likely, remain a top priority spending item for the government going forward.

92% YoY jump in 9M14 net profit to TRY246mn. There was a strong operating performance as revenues grew 23% YoY to TRY1,781mn with EBITDA up 15% during the same period. The TRY was weaker in 9M13 than in 9M14, leading to lower FX losses on its US$ denominated "advances on orders", and this was largely behind the YoY surge in the 9M14 bottom-line. These FX losses (and gains) are non-cash and are recorded as revenues in later periods, so do not have a real impact on the financials.

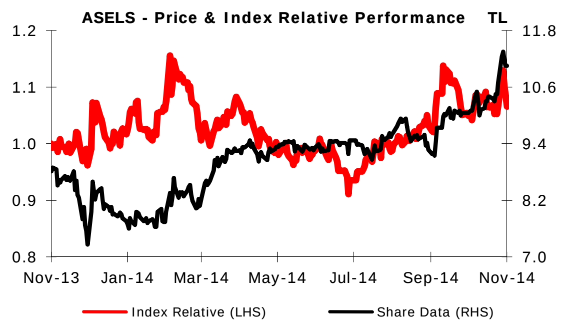
End Sept. backlog of US$3.9bn compared to US$4.0bn at the end of June. Aselsan's projects are long-term in nature and extend up until 2025. Aselsan's backlog to 4Q trailing sales ratio stands at 3.3x. The company's net debt position rose from TRY374mn at the end of June to TRY395mn at the end of September.

DIU projects such as Milgem marine vessels, Altay tanks and new anti-missile system will at least keep the backlog near current levels. The delayed new missile system contract looks likely to go ahead now that negotiations have shifted from a Chinese to a French provider. The Altay tank project, with an expected backlog addition of US$1.5bn (potentially in 2015) would significantly boost Aselsan's backlog further. <u>We have a Market Outperform rating for the stock with a 12 month target price of TRY13.20.</u>

Stock Data

Ticker (Reuters, Bloomberg)	ASELS.IS, ASELS TI
Market Cap. (TRYmn)	5,525
Number of Shares (000)	500,000
Free Float	15%
Daily Vol. (3 Month, TRYmn)	8.6
Net Debt (2014/09, TRYmn)	433
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TRY	3.3%	10.0%	15.1%	25.4%
Index Rel.*	-0.2%	1.5%	7.9%	6.6%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
Net Sales	1,633	2,171	2,519	2,897
EBITDA	252	436	473	559
EBITDA marg.	15.4%	20.1%	18.8%	19.3%
Net Profit	293	238	399	472
EV/Sales	1.6	2.2	2.4	2.1
EV/EBITDA	10.7	12.2	12.6	10.7
P/E	9.3	23.2	13.8	11.7

Shareholding Structure

Turkish Army Benevolent Fund	84.6%
Other	0.1%
Free Float	15.3%

Turkish Equities / Cement / Company Update

Cimsa

Raising target price with inclusion of Afyon Cement in our valuation

OUTPERFORM
Current price: TRY 15.75
12-mo T.Price: TRY 19.00

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We maintain our "Outperform" rating for Cimsa with a 12-month TP of TRY19.00 (incorporating the Afyon plant's capacity expansion in our valuation). Although the stock has outperformed the BIST-100 total return index by 18% YtD, we still favour Cimsa on the back of its high-margin, diversified product portfolio (i.e. white cement), organic growth potential and its high dividend yield (~9%). We project a CAGR of 9% in revenues and 13% in EBITDA over the 2013-16F period for Cimsa, based on the bright outlook for the cement sector.

Afyon Cement's total capacity will be tripled. Cimsa acquired a 51% stake in Afyon Cement for TRY57.5mn in June-2012. Afyon Cement has a current annual clinker capacity of 450k tonnes, and since the acquisition Cimsa has been working on feasibility studies to renovate and relocate the plant given its current obsolete technology and location (the existing plant is still close to the Afyon city centre). In this vein, Cimsa purchased a plot outside of the city for TRY1.9mn, on which it will build the new plant and triple its annual production capacity to 1.5mn tonnes in an estimated total investment of US$165mn. In order to finance this investment, Afyon Cement will make a rights issue (3,233%) and increase its capital by TRY97mn (to TRY100mn from TRY3mn). Total cash outflow from Cimsa is calculated as TRY50mn. With this capacity upgrade, Cimsa will boost its grey clinker capacity by ~20%. The management stated that the new plant will be in operation by end-2016. We believe Afyon's capacity expansion would strengthen Cimsa's market share and pricing power in the Central Anatolia region in the long run.

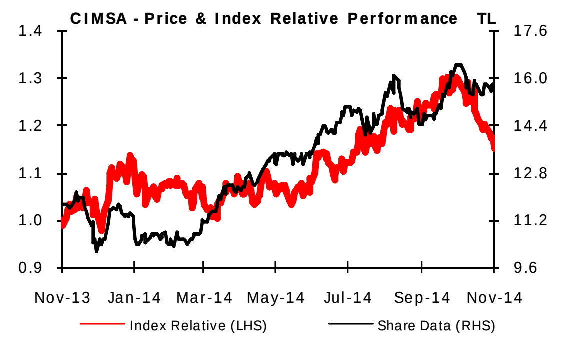
White cement playing a vital role in sustaining profitability. Cimsa's current strategy is to further promote its white cement business, as it plans to raise the number of export destinations and expand its foreign terminal network in a bid to secure higher profitability and top-line growth going forward. White cement is a niche product sold globally, and almost twice as expensive as grey cement.

Sancim acquisition awaiting approval from the Competition Board. Cimsa signed the share purchase agreement with the stakeholders of Sancim for US$220.7mn in July. Sancim has a clinker capacity of 1.1mn tonnes per year (which would result in a 20% capacity increase for Cimsa) with its production plant located in Bilecik in the Marmara region, where demand is brisk amid big-ticket infrastructure and urban transformation projects. Any developments regarding the Sancim deal would also support the share price and act as a catalyst for the stock in the short and mid-term.

Stock Data

Ticker (Reuters, Bloomberg)	CIMSA IS, CIMSA TI
Market Cap. (TRYmn)	2,134
Number of Shares (000)	135,084
Free Float	22.6%
Daily Vol. (3 Month, TRYmn)	2.0
Net Debt (2014/09, TRYmn)	146
BIST-100 Index (TRY)	83,282

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TRY	1.0%	1.0%	9.7%	37.2%
Index Rel.*	-1.6%	-5.9%	3.9%	20.8%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
Net Sales	857	954	1,099	1,190
EBITDA	211	236	329	348
EBITDA marg.	25%	25%	30%	29%
Net Profit	115	302	218	234
EV/Sales	1.5	1.6	1.8	1.7
EV/EBITDA	6.2	6.3	6.1	5.8
P/E	9.8	5.2	9.8	9.1

Shareholding Structure

Sabanci Holding	49.4%
Aberdeen Asset Management	13.8%
Akcansa	9.0%
Others	5.2%
Free Float	22.6%

AKInvestment

Turkish Equities / REIC / Company Update

Emlak Konut

Trading in the basement

OUTPERFORM
Current price: TRY 2.82
12-mo T.Price: TRY 3.65

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'Outperform' rating maintained. Emlak is trading at a 21% discount to its NAV/share of TRY3.56 (3Q14) vs. its historical discount of 15%. We believe the stock is the best pick of improving macro environment that should support Emlak's both unit sales and pre-sales revenues in 2015. Moreover, Emlak REIT has tendered RSM projects at higher profit multiples in the last 1.5 years, which are not yet captured in its NAV. This implies an attractive effective discount to its NAV, while the dividend yield of c.4% is also supportive of the valuation.

Pre-sales performance to gradually accelerate in the coming months. Emlak's 2014 pre-sales target stands at 10,000 new homes (in line with our forecast) with the launch of new projects in the pipeline in 4Q14. Note that Emlak's pre sales volumes stood at 7,533 homes at the end of October (pre-sales revenue of TRY3.76bn in 10M14) and recently launched two RSM projects are expected to support Emlak's pre-sales performance in the coming months.

SPO proceeds channeled into land acquisitions. Emlak had spent all of its SPO proceeds (TRY3.25bn) on land acquisitions (especially in the new city area) during 2Q14. Moreover, the management stated that they were capable of buying and tendering TRY3-4bn worth of land every year.

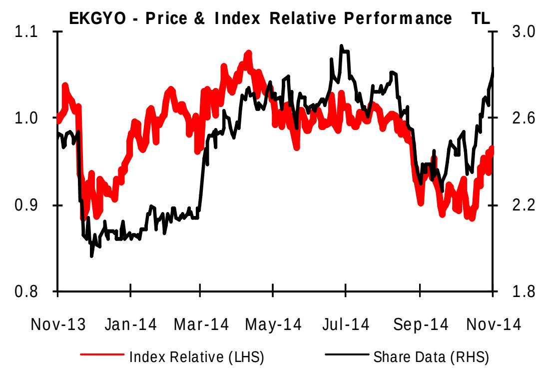
Istanbul's new city; Emlak's new value creation area. Beyond 2015, the value creation from the tracts of land purchased in Istanbul's new city area will gradually become apparent. Emlak had a total 9.5mn sqm land-bank portfolio at the end of 9M14, of which 5.2mn sqm was located in Istanbul's new city area. Accordingly, the management guided that the multipliers of the city area tracts of land would reach four to five times their appraisal values (vs. Emlak's 2.2x of 2014 tender multiple average) within 5 years with the completion of the new Airport, the North Marmara highway and the government's 8 large scale hospitals, which will boost the white-collar population in the region.

Residential sector offering robust long term growth prospects. In the longer run, the management believes the dynamics of residential market offer robust growth prospects. The study conducted by the GYODER (the Association of Real Estate Investment Companies) suggests that Turkey needs 600k new homes per year to meet its housing needs, driven by growing population, urbanization (currently; 72% vs. 2023 target of ~80%), urban transformation and renewals. Note that an average of 700k homes have been sold in Turkey each year (with Istanbul claiming the lion's share, at 24% of total sales). Moreover, an average 25% of total household expenditures go to rental expenditures in Turkey, exceeding the 20% for food expenses. Thus, the decline in mortgage rates will prove crucial in attracting the middle classes to the credit pool that will drive residential demand and help realize the potential of the sector.

Stock Data

Ticker (Reuters, Bloomberg)	EKGYO IS, EKGYO TI
Market Cap. (TRYmn)	10,716
Number of Shares (000)	3,800,000
Free Float	50.7%
Daily Vol. (3 Month, TRYmn)	122.4
Net Cash (2014/09, TRYmn)	2,321
BIST-100 Index (TRY)	83,282

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TRY	5.1%	12.6%	-1.1%	4.5%
Index Rel.*	2.5%	4.9%	-6.3%	-7.9%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
Net Sales	1,005	2,331	2,050	2,218
EBITDA	396	909	740	986
EBITDA marg.	39%	39%	36%	44%
Net Profit	523	1,061	910	1,174
EV/Sales	3.7	2.2	4.1	3.8
EV/EBITDA	9.4	5.6	11.3	8.5
P/E	11.6	7.0	11.8	9.1

Shareholding Structure

TOKI	49.3%
Free Float	50.7%

Turkish Equities / Banks/ Company Update

Isbank

An unjustifiably deep discount on multiples

OUTPERFORM

Currentprice: TRY6.16
12-mo T.Price: TRY7.30

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Isbank remains one of our picks with its attractive valuation and strong earnings catalyst, especially in the first half of 2015 due to seasonality of dividend income. The Bank outperformed the banking index by ~2% in last month, but has still underperformed its peer banks by ~2% on aYtD basis. We believe its current 2015F P/E of 7.5x and P/B of 0.9x mark an undeserved discount. After raising our price target by 18% to TRY7.30, we find 19% upside for Isbank. We thus maintain our 'Outperform' rating.

As the sole large cap bank to have considerably eclipsed estimates in the last quarter, Isbank managed to report 1.2% YoY earnings growth in 9M14 vs. the 9.1% YoY aggregate contraction for our coverage. The strong result in 9M14 is mostly a result of Isbank's ability to cut its loan loss provisioning costs thanks to a decline in net NPL growth in 9M14 (vs. a pick-up trend in the sector). Thus Isbank's NPL ratio retreated by 5bps YtD (with the impact of TRY225mn NPL write-off) to 1.6% by the end of 3Q14 in contrast with the 17bps YtD increase (with TL2.9bn of NPL write-offs) in the sector's average NPL ratio to 2.9%. Meanwhile, the bank's NPL coverage, at 77.4% (despite a 300bps YtD decline) remained higher than the sector's average NPL coverage at 72.8%, keeping the impact of the ageing factor relatively low.

As well as its attractive valuation, Isbank has relatively little foreign ownership (compared to a year ago) and its discount on its P/B multiple relative to the sector average is now wider than the historic trend.

Isbank's loan growth, at 11.9% YtD in 9M14, was mainly driven by TL loans, whilst the bank focused more on FX deposits and expanded use of swap funding on the funding side.

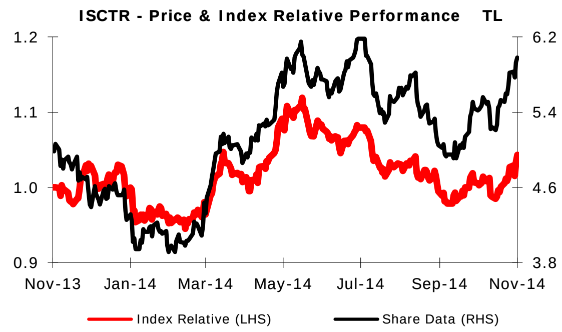
When compared with its peers, Isbank was relatively less aggressive in fee generation and **the recent regulations on fees and commissions will have a smaller effect on its P/L than for other large cap private banks.**

Upside challenges: Isbank's relatively longer duration loan book and the wide negative maturity gap in its peer group may bring upside to the NIM with the downward trend in interest rates.

Risks: The lack of a major catalyst or a negative earnings surprise due to the difficulty in estimating its FX trading gains/losses may depress investor appetite.

Stock Data	
Ticker (Reuters, Bloomberg)	ISCTR.IS, ISCTR TI
Market Cap. (TRYmn)	27,720
Number of Shares (000)	4,500,000
Free Float	31.6%
Daily Vol. (3 Month, TRY mn)	204.6
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TRY	5.8%	13.4%	8.8%	23.6%
Index Rel.*	2.3%	4.8%	2.0%	5.0%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
T. Assets	175,444	210,500	236,857	269,687
Sh. Equity	22,719	23,579	28,023	31,173
T. Loans	106,716	134,843	155,840	183,879
Net Profit	3,310	3,163	3,300	3,700
RoE	16.5	13.7	13.0	12.5
P/B	1.3	1.3	1.0	0.9
P/E	8.4	8.8	8.4	7.5

Shareholding Structure	
Isbank Pension Fund	40.3%
Ataturk shares (the RPP)	28.1%
Free Float	31.6%

Kardemir D

Adding value as investments are completed

OUTPERFORM

Currentprice: TRY2.13

12-mo T.Price: TRY2.90

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We have a 12-month target share price of TRY2.90 for Kardemir D and an 'Outperform' rating. We have adjusted our 12 month target share price from the previous TRY2.80 based on our lower cost of equity assumption. We believe Kardemir will face some headwinds in 2015 with narrowing spreads, but with new investments coming on-stream from 2016, we expect Kardemir to maintain an EBITDA margin of over 19%, even in the face of potential volatility in raw material and sales prices. We believe the recent share price weakness provides an attractive entry point given the strong share price appreciation in the past year, reflecting the unprecedentedly wide spread between raw material and sales prices.

Spreads set to narrow going forward. We believe spreads between steel prices and raw material priceswill continue to narrow as demand for steel from China declines. We therefore maintain our forecasts going forward, projecting a narrowing in the EBITDA margin to 19.4%. Kardemir has new investments coming on stream from 2016 (wire rod rolling mill plant and train wheels) which will enhance profitability. Hence, any volatility in spreads should be cushioned by the introduction of these new products.

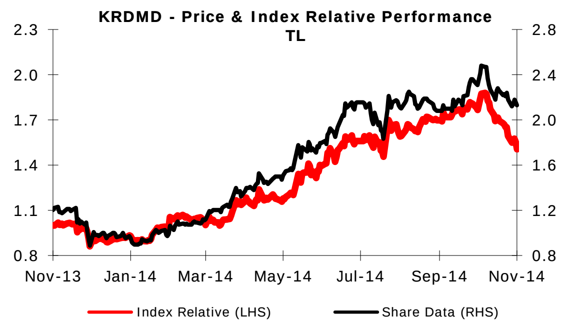
Demand drivers in place. Steel sector demand remains strong in Turkey. Kardemir's sales volumes were up by around 15% YoY in 9M14 and we expect a similar growth figure for the full year. Private construction and public infrastructure activity remains robust and we expect this buoyant trend to continue. The Urban Transformation project is expected to be a long term driver of domestic construction growth. Similar demand is likely in the region (the Middle East and Gulf states). After some weakness this year, rail demand is expected to recover in 2015 and going forward.

Steel prices expected to exhibit some recovery. Kardemir's General Manager recently announced that the No.5 blast oven furnace, with a 1.25mn tonne annual crude steel production capacity, would enter commercial operation within 2 weeks (the 2nd week of December) bringing its total annual production capacity to 3mn tonnes, and that in excess of US$900mn had been spent on the project in recent years, including necessary investments in energy and processing of raw materials. The GM also spoke about steel prices, citing considerable price declines of late, in parallel with world prices. The main driver of this has been the Chinese market, but he believes prices have now bottomed out and that there will be an upturn in prices going forward.

Stock Data

Ticker (Reuters, Bloomberg)	KRDMD IS, KRDMD TI
Market Cap. (TRYmn)	1,662
Number of Shares (000)	780,226
FreeFloat	89%
Daily Vol. (3 Month, TRYmn)	96.8
Net Debt (2014/09, TRYmn)	684
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November 2014



StockPerformance

	1W	1M	3M	1Y
TRY	-2.3%	-7.8%	0.9%	77.0%
Index Rel.*	-5.6%	-14.8%	-5.4%	50.5%

** vs. BIST Total Return Index*

Forecasts (TRYmn) (All share types)

	2012	2013F	2014F	2015F
Net Sales	1,687	1,812	2,180	2,616
EBITDA	309	329	525	518
EBITDA marg.	18.3%	18.2%	24.1%	19.8%
Net Profit	194	100	291	306
EV/Sales	1.9	1.8	1.5	1.2
EV/EBITDA	10.5	9.9	6.2	6.3
P/E	12.5	24.2	8.3	7.9

Shareholding Structure

Kardemir Employees	21.1%
Chambers of Commerce	10.5%
Free Float	68.4%

Pegasus Airlines

Strong tailwinds

OUTPERFORM

Current price: TRY 32.40
12-mo T.Price: TRY 38.00

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We maintain our "Outperform" rating for Pegasus. We expect the recent strength in the share price, triggered by a better than expected yield performance in the 3Q financials and, in particular, the steep decline in oil prices, to extend into the coming days. Pegasus shares have outperformed the BIST-100 Total return index by 12% in the last month and a half. Our new 12 month TP of TRY38.00 implies 17% upside potential. At a 2015E EV/EBITDA of 8.0x, Pegasus is trading roughly on a par with its peers.

A leading beneficiary of the fall in oil prices. With fuel costs making up 44% of the total cash costs, Pegasus stands among the major beneficiaries of the decline in oil prices. All else being equal, a 20% decline in fuel costs would lead to a 25-30% improvement in Pegasus's EBITDA. We note that the price of a barrel of Brent crude has fallen by over 35% since June 2014, and the recent "no supply cut" decision from OPEC and large build up in 1H15 inventories assure us of the prospect of a substantial oil market surplus in 1H15, putting further downward pressure on oil prices.

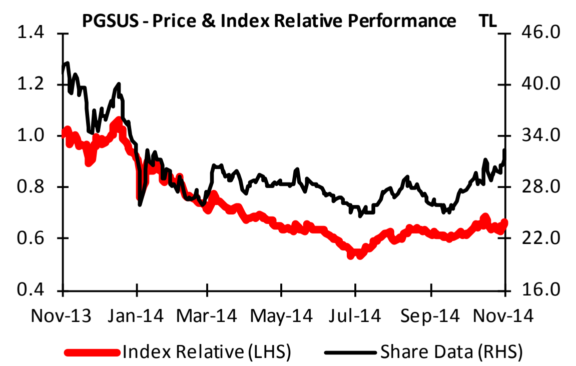
… though the positive impact on operating profitability will likely be realized rather gradually. The expansion in the airline's operating margins will be limited by a number of factors, particularly the airline's hedging policy (as of 9M14, Pegasus had hedged around 66% of its 2015 fuel costs at a price 15-20% above the current market price) and the fall in the EUR against the US$ (45% of revenues are EU denominated, vs. 17% of costs, while 9% of revenues are US$ denominated, vs. 57% of costs).

Pegasus shares have underperformed rival THY by 11% in the last two months. THY's fuel cost hedging policy (a 24 month decreasing layered hedge that covers 32% of the estimated 2015 fuel cost at a price range of $80-140/bbl for brent oil) puts THY in a relatively advantageous position. However, if oil prices remain low for a prolonged period in parallel with our forecasts, Pegasus would likely be able to catch up with market prices earlier than THY, due to the difference in hedging strategies.

Risks. The key risk ahead is a softening trend in pax volumes. Pegasus recorded YoY pax growth of 25% in 1Q14, 20% in 2Q14 and 15% in 3Q14 (adding up to 19% YoY in 9M14), and we calculate that the YoY pax growth lost some momentum in October (estimated at 14% YoY). The management's running target is for 18% pax growth in 2014 (pulled down after the 3Q14 results). Plus, the uptrend in ticket prices is unlikely to be sustained, given the fall in oil prices (fuel surcharges on tickets sold are expected to be lowered).

Stock Data	
Ticker (Reuters, Bloomberg)	PGSUS IS, PGSUS TI
Market Cap. (TRYmn)	3,314
Number of Shares (000)	102,272
Free Float	34%
Daily Vol. (3 Month, TRYmn)	55.9
Net Debt (2014/09, TRYmn)	261
BIST-100 Index (TRY)	83,282

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TRY	8.4%	17.2%	20.4%	-21.5%
Index Rel.*	4.7%	8.2%	12.2%	-33.3%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
Net Sales	1,920	2,404	3,128	3,610
EBITDA	293	412	408	505
EBITDA marg.	15.3%	17.1%	13.0%	14.0%
Net Profit	126	92	235	260
EV/Sales	2.4	1.7	1.3	1.1
EV/EBITDA	15.5	9.9	10.0	8.0
P/E	26.2	36.1	14.1	12.7

Shareholding Structure	
Esas Holding	62.9%
Sabanci Family members	2.6%
Free Float	34.5%

Tekfen Holding

Poised to receive new contracting projects in the short-term

OUTPERFORM

Current price: TRY 6.03

12-mo T.Price: TRY 7.82

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Potential upside from contracting segment in 2015. We conservatively expect a contracting margin of 7% for Tekfen Holding in 2015. A stronger than expected contribution from projects in Azerbaijan (with a backlog of US$1.3bn, constituting 59% of the company's total backlog) could bring potential upside to our forecasts (US$15mn for each 1pp deviation from our 2015 EBITDA margin forecast).

Vertical integration in agri business to support margins. Following the US$300mn investment by the end of this year, Toros Agri will be self-sufficient in its sulphuric and phosphoric acid needs, and we forecast that its fertilizer EBITDA margin will improve by 40bps to 12.3% in 2015 compared to the 11.9% average over the last eight years. A higher than expected contribution may bring US$5-10mn of upside to our 2015 forecasts.

Potential projects in 2014. Socar's Star refinery (estimated potential contribution of around US$500mn) and TANAP projects (Initial phase to be composed of 3 lots with a total estimated size of US$1.5-2.0bn) are potential projects which could serve as short-term catalysts on any positive news flow.

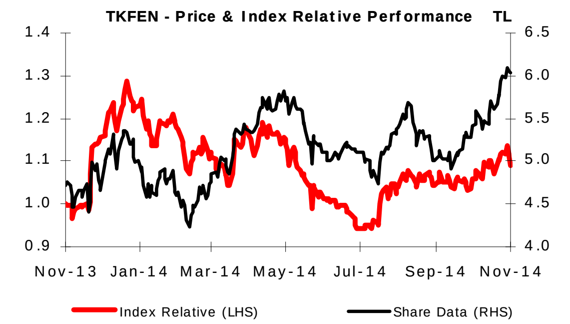
Attractive valuation. Tekfen Holding shares are trading at a 2015 P/E of 8.6x compared to the 11.8x average for international peers and 12.2x average for local peers.

Risks. Uncertainty surrounding the suspended Libya project (US$100mn backlog) and uncollected receivables (US$80mn) connected to the project continues. Furthermore, weakness in oil prices is negative for Tekfen, as this could hinder the award of contracts from oil-exporting countries. Increasing competition and political risk in the MENA region is a risk to Tekfen's profitability and future growth prospects. In addition, margins in the fertilizer business are vulnerable to changes in raw material prices, which are mainly determined in global markets.

Stock Data

Ticker (Reuters, Bloomberg)	TKFEN.IS, TKFEN TI
Market Cap. (TRYmn)	2,231
Number of Shares (000)	370,000
Free Float	46.3%
Daily Vol. (3 Month, TRYmn)	23.7
Solo Net Cash (2014/09, TRYmn)	701
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November 2014



Stock Performance

	1W	1M	3M	1Y
TL	0.5%	11.5%	11.9%	28.0%
Index Rel.*	-2.9%	2.9%	4.9%	8.8%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
Net Sales	4,076	4,000	4,496	5,279
EBITDA	283	10	403	444
EBITDA marg.	6.9%	0.2%	9.0%	8.4%
Net Profit	299	-64	295	259
EV/Sales	0.5	0.5	0.5	0.4
EV/EBITDA	7.3	n.m.	5.1	4.6
P/E	7.5	n.m.	7.6	8.6

Shareholding Structure

Berker Family	19.3%
Gokyigit Family	19.3%
Akcaglilar Family	10.9%
Other	4.2%
Free Float	46.3%

Turkish Equities / Banks/ Company Update

Vakifbank

Still offering attractive upside

OUTPERFORM
Currentprice: TRY5.10
12-mo T.Price: TRY6.10

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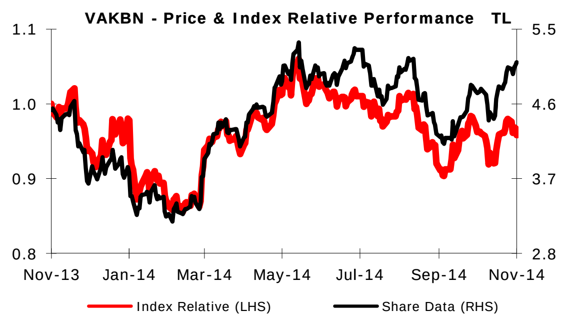
- **After increasing our profit forecasts for Vakifbank by 25% for 2015 and 7% for 2016, we have raised our 12 month price target by 27% to TRY6.10, finding 20% upside, warranting an upgrade in our rating to 'Outperform'.** With one of the widest maturity gaps and relying heavily on TL assets, **Vakifbank is a major beneficiary of the easing cycle**.
- Additionally, the management's recent decision to divest its Visa and Mastercard shares (held in its available-for-sale) portfolio is likely to provide a boost of around TL250mn – 300mn to the bottom line and improve the bank's Tier-1 ratio by 20bps – 25bps. Finally, the Bank seems to have outperformed the BIST-100 index by 5% and yet still underperformed the banking sector index by 1.0% on a YtD basis.
- **The easing in provisioning policy may be a major catalyst for Vakifbank in 4Q14.** With the reduction in the provisioning rate of Group IV loans to the legal cap of 50% down from 100% (bringing the overall NPL coverage from 94% at the end of 3Q14 to 88%), the Bank may release around TRY220mn from its loan loss provision reserves and report a YoY increase in its earnings.
- The management stated that **the transfer of the 58% stake held by the General Directorate of Foundations (GDF) to the Treasury could be completed by the end of 1H15**, adding that the main reason for this transaction was to provide cash to the GDF for its restoration work, and bore no relation to an SPO. We do not see any prospect of an SPO in the next 1 – 2 years. The Pension Fund (which holds a 16% stake in the bank) will be also given a put option at a discounted price (GDF has a control premium).
- After the completion of the share transfer, **Vakifbank expects more focus on the establishment of the participation banking business,** since the Treasury will inject a fresh US$300mn of capital into the Bank for this investment.
- There was around TRY91mn in additional operating costs resulting from reimbursements of commissions in 9M14. An easing in this item is expected in 2015, with operating costs rising by around CPI +200bps.
- **Upside challenges:** A positive surprise in earnings thanks to a strong collection performance and/or reduction of NPL coverage on Group IV loans may provide upside to our valuation.
- **Risks:** An unexpected rapid hike in interest rates would take a heavy toll on its NIM, because of maturity gap and TL weighted balance sheet.

Stock Data	
Ticker (Reuters, Bloomberg)	VAKBN.IS, VAKBN TI
Market Cap. (TRYmn)	12,750
Number of Shares (000)	2,500,000
Free Float	25.3%
Daily Vol. (3 Month, TRY mn)	255.7
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November2014



Stock Performance

	1W	1M	3M	1Y
TRY	1.2%	7.8%	1.2%	12.7%
Index Rel.*	-2.2%	-0.4%	-5.2%	-4.2%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
T. Assets	104,580	135,496	151,394	171,561
Sh. Equity	11,918	12,616	14,461	16,334
T. Loans	67,868	86,496	101,190	117,888
Net Profit	1,460	1,586	1,500	2,000
RoE	13.9	13.0	11.2	12.9
P/B	1.1	1.0	0.9	0.8
P/E	8.7	8.0	8.5	7.3

Shareholding Structure

Foundations managed by GDF	58.5%
Vakifbank Pension Fund	16.2%
Free Float	25.3%

Turkish Equities / Banks/ Company Update

Yapi Kredi Bank

Poised for rapid organic growth

OUTPERFORM

Currentprice: TRY5.32

12-mo T.Price: TRY6.30

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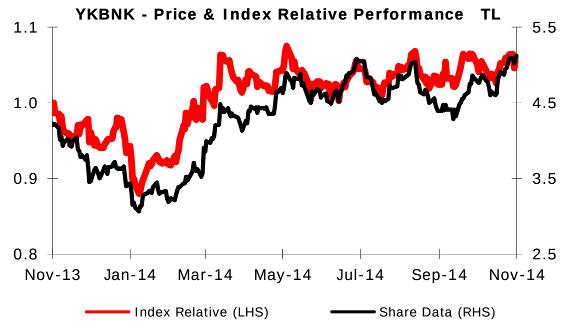
- With the market welcoming the bank's faster than average growth, Yapi Kredi has outperformed the banking sector by 6% and the BIST-100 by 12.5% so far this year. **We have upgraded our rating for Yapi Kredi to 'Outperform' on the back of its attractive growth plans, barring a major growth related asset quality risk, which we do not deem likely.** After raising our 12 month price target by 29% to TRY6.30 per share, Yapi Kredi shares now offer 18% upside.
- **After four years in the doldrums, Yapi Kredi is now growing on all cylinders to achieve its plan to be Turkey's top private bank with a 14% market share in loans within 5 years** (from the current 9.8%) through organic growth. Since the end of 2013, the Bank has been able to add a modest 0.3pp in market share in loans - still ~1pps less than in March 2009. Yapi Kredi's growth plans seem challenging, but the post-sale period at Garanti may ease the competitive conditions, if the future controlling owner, BBVA, opts for internal restructuring.
- To achieve this target, the number of employees has increased by 13% YtD, vs. an increase of only 1% in the whole banking system. The Bank plans to reach a network of 1,003 branches by the end of 2014, up from 978 at end-3Q14 During the 5-year investment period, the RoE is expected to be 100bps lower than the sector average and beat the sector average by 100–200bps from the sixth year.
- The credit card franchise was an effective tool to gain 30% of the 315,000 new clients added in 2014, at almost 40% of the cost of acquisition for non-card customers.
- To secure healthy growth, the bank has internal thresholds for its solvency, asset quality and liquidity ratios and does not expect an abrupt surge in its NPL portfolio. The internal threshold for the CAR stands at 14%. If needed, it will be improved by issuing sub-ordinated debt, Tier-1 debt (under Basel III criteria) and/or finally a capital injection. Meanwhile, the bank's loan / deposit ratio is planned to be maintained at its current level of 114% (bank-only).
- **Upside challenges:** the managerial ability to execute aggressive growth targets may positively differentiate Yapi Kredi from its peers.
- **Risks:** If the management falls significantly short of its growth targets, we may see a sell-off. Yapi Kredi has the lowest NPL coverage among the listed large cap private banks, at 73% (the same as the sector average) and could therefore feel more provisioning pressure if a severe deterioration in asset quality were to hit. Finally, regulations on fees and commissions will hit the bank relatively hard, because of its larger credit card franchise.

Stock Data

Stock Data	
Ticker (Reuters, Bloomberg)	YKBNK.IS, YKBNK TI
Market Cap. (TRYmn)	23,126
Number of Shares (000)	4,347,000
Free Float	12.8%
Daily Vol. (3 Month, TRY mn)	58.9
BIST-100 Index (TRY)	86,169

Stock data is as of 28 November2014



Stock Performance

	1W	1M	3M	1Y
TRY	4.5%	11.8%	9.5%	26.5%
Index Rel.*	1.0%	3.2%	2.6%	7.5%

** vs. BIST Total Return Index*

Forecasts (TRYmn)

	2012	2013	2014F	2015F
T. Assets	122,180	148,881	172,507	198,806
Sh. Equity	16,862	17,309	19,338	21,453
T. Loans	74,795	94,891	114,503	136,206
Net Profit	1,913	3,203	1,850	2,300
RoE	13.8	18.7	10.2	11.3
P/B	1.6	1.6	1.4	1.2
P/E	12.1	11.4	12.5	10.1

Shareholding Structure

Shareholding Structure	
Koc Financial Services*	81.8%
Dodge & Cox Int. Stock Fund	5.4%
Others	12.8%

** Koc Group &Unicredit have a 50:50 share in KFS*

How we see the global backdrop…

2015: global investment themes at a glance

1. Global growth: going it (mostly) alone…

A decline in growth momentum in recent months has raised questions over the global growth outlook, but we actually expect growth to turn out stronger in 2015 than in 2014. The most material growth issue is the feedback loop – the extent to which mediocre non-US growth and a strong dollar delay or limit the Fed's tightening. In the broader picture, the big debate on "secular stagnation" is likely to continue in earnest.

- The **U.S.** economy has re-emerged as a growth leader; but it cannot serve as the world's sole growth engine, as other major economies are not necessarily following its lead.
- In **Europe**, the spectre of a double-dip recession has given way to the prospect of protracted stagnation; GDP growth may improve slightly, but will still remain in the doldrums.
- In **Japan**, the spurt of nominal growth spluttered to a halt, and another dose of stimulus will be needed to sustain the reflationary momentum.
- In **China**, the cyclical progress in the economy can be best described as "two steps forward, one step back", with the authorities seeking to juggle both reforms and growth at the same time.
- **EM growth** is also undermined by faltering capital spending both in China and many other developing economies. EM demand for capital goods and commodities continues to contract, while 2015 growth is likely to remain sub-trend.

2. Inflation & monetary policy - Meet "lowflation", where slack remains extensive and wage pressure slow to return, commodity disinflation flows through, and negative rates, asset purchases and FX interventions may create a bubbly environment for certain risk assets

- **Policy divergence…** The stage of business cycles in the US and the UK, on the one side, and in the Euro Area and Japan, on the other, calls for ongoing differentiation in the stance of monetary policy adopted by the respective central banks. The Fed and the BoE are waiting to raise rates, while holding their balance sheets constant; while the BoJ and ECB are expanding their balance sheets, setting the stage for an increase in global liquidity. This, in turn, has implications in terms of capital flows.

  - **Balance-sheet wars have escalated and large scale currency moves are likely.** The currency market is the main mechanism for redistributing deflationary pressures among nations.
  - **In the US**, with continuing labour market strength, the focus has shifted to inflation, which is set to soften in the short-term on lower oil prices, but is likely to later gradually pick-up. A stronger dollar will dampen the pricing power of the U.S. economy, drive down inflation expectations and allow bond yields to sink even lower. The Fed could hike rates in late-2015, though there is a risk of a delay.
  - **In Europe**, inflation remains too low, and the easing measures taken to date are unlikely to prove adequate in raising inflation back to the target. As a result, we expect the ECB to deliver public QE as early as 1Q15.
  - **Emerging markets are exacerbating global deflationary risks…** In a stagnant world, the EM area will be a source of excess global savings, which will cap the upside of G7 government bond yields further.

- **Commodity cycle…** A prolonged stasis in oil following the "no cut" decision by OPEC - which has relinquished its "swing producer" role to the proverbial "invisible hand", leaving the market to adjust supply / demand through price moves - creates yet another disin(de)flationary dynamic, although lower oil prices will offer a welcome tailwind for the consumer. If anything, the oil price outlook signifies the protraction of a low inflation – low interest rate environment.

3. The much vaunted U.S. rate normalisation: the conundrum returns due to secular stagnation and central bank asset purchases that cause duration scarcity in fixed income markets

- **An "exit" may be needed, but is likely to be delayed due to the massive uncertainty over modalities, implications, political constraints on the economy and fear of excessive currency appreciation.** Fed tightening is a recipe for a Treasury bear market, but we are in fact already seeing more US tightening coming through the USD than the Fed would like. A lower inflation picture and the asymmetric risks around moving too early will force the Fed to delay the first rate hike until late 2015 at the earliest, and more probably until 2016. The Fed will turn a blind eye to wage inflation for some time as weak productivity and lack of pricing power hamper the late-cycle profit picture.

- **Tightening will be slow, with monetary authorities reluctant to rock the boat lest they swamp it.** The exit should prove more manageable than feared. The downward pressure on long-dated yields from international easing and disinflation will be helpful here, while the Fed funds terminal rate in this cycle should not exceed 3.0%. Upward pressure at the short-end of the Treasury curve will persist in the absence of further dollar strength. Nonetheless, QE outside the US is likely to limit the long-end sell-off, and set the conditions in place so it is easier for the market to adjust to Fed tightening. The spill-over effects of the BoJ duration absorption is likely to benefit higher-yielding bond markets. We expect a big US bear flattening.

4. The markets - A low-return world: major asset classes offering low absolute returns; equity yields looking attractive in a low-return world, especially in the EM area; FX will be a relentless shock absorber and a more important component of returns

- With activity improving modestly and overall global policy settings benign, the asset market backdrop is still broadly constructive. In a world of sluggish growth and persistent monetary policy action, **equities are still the preferred asset class.** Bond yields may rise slightly after 1Q15, while oil prices should hold onto their recent declines. In FX markets, the continued USD strength is likely to continue unabated, particularly against other G10 currencies.

- **Volatile markets…** Economic growth is too weak to cope with plunging asset prices. Newton's Third Law (for every action, there is an equal and opposite reaction) is very apt for 2015. When US wages gain the upper hand, rates will go up and equities will go down. Then the Fed will likely postpone its first rate hike, and raise the short-term interest rate very gently for quite some time to come; then rates will adjust downward, and equities will go up.

- **The carry trade does not end with the Fed exiting the ZIRP;** it may increase with Japan and Europe offering ZIRP and depreciating currencies. In the US and UK, the front-end of the curve may steepen as we approach the beginning of Fed and BoE hiking cycles, but a flattening bias should prevail at the long-end on expanding G4 balance sheets. On the back of the "Draghi put", either the economy will pick up, lifting risk appetite, or the ECB will start a sovereign QE programme that will have a similar impact. Prepare for intra-EMU spread tightening while peripheral spreads should narrow on ECB QE.

- **The external backdrop is likely to be EM asset-friendly:** Growth in China has softened; lower commodity prices will provide inflation relief; a broadening DM recovery should help EM exports; developed market growth risks on the whole remain balanced with inflation more likely to decline; hence the BoJ and the ECB should continue to anchor a friendly fixed income environment through their words and actions. All in all, a moderately supportive backdrop for EM fixed income assets and further breathing space for EM policymakers stays in place in 2015, as EM growth continues to underwhelm, although the scope for volatility around the Fed lift-off remains. As EM headline inflation falls, local bonds may continue to perform, while the EMFX could broadly move in line with global factors and act as the first line of defence vs. the USD as EM – US rate differentials narrow.

5. Risks: Shocks from Euro area and China still the big risks

- **Eurozone risks could flare up with the re-emergence of Euro area political tensions**, also escalated by the rise of non-mainstream parties in the Euro area. Provided the legality of sovereign QE is not questioned, which is our central scenario, risks stemming from European politics will only have a temporary impact, and will be easily absorbed by the market, given the implicit ECB protection.
- **A delayed or even stalled process of ECB balance sheet growth**, particularly in the absence of a fiscal alternative, which would likely largely prevent euro depreciation and cast risks over asset performance.
- **Risk asset pricing is negatively related to real rates, in contrast with the pre-crisis period.** It still appears to be the case that growth is bad, in the sense that it would increase the probability of premature Fed tightening.
- **As the Fed rate hike approaches, the funds that have flowed into emerging markets in recent years will look for an exit and find a narrow doorway**, giving rise to greater emerging-market volatility
- **Wage inflation may prove higher than expected in the US/UK.** Fed tightening in response to accelerating wages may be problematic, as the US corporate sector may defend margins in the face of limited pricing power, low productivity, and higher wage costs by slowing the pace of labour input growth.
- **A sharper downward shock from China's housing and credit imbalances is a key risk**, although we do not expect a hard landing.
- **Geopolitical and local political issues will remain significant risks in 2015.** We assume some middle ground in the Russia – Ukraine and Middle East crises.
- **Upside challenge:** a more prolonged environment of lower oil prices

Global Macro Backdrop

Secular stagnation, one year on…

Chronic demand-deficiency syndrome… The dominant problem facing the world economy is the weakness in aggregate demand versus aggregate supply, leading to lower inflation and even deflation risks in some regions. Against this backdrop, the private sector savings rates in most Western economies remain elevated due to deleveraging, while traditional sources of spending have also been affected by structural weakness amid restrained U.S. household spending, softening Chinese capex and surging excess savings in the Euro Zone. **In fact, the U.S., China, the EU and Japan, taken together, have reported a current account surplus for the first time in 20 years.**

Global imbalances, shifts in income distribution and structurally weak investment have all led to an inability to generate credit-driven demand (i.e. re-leveraging) on a pre-crisis scale. Demographic changes also play a role, as the "baby boomers" have reached pensionable age, and have become more inclined to save. Consequently, ex-ante savings are globally exceeding investment demand, driving real equilibrium rates to very low or even negative levels to stabilize domestic demand. More and more monetary stimulus is needed to maintain a constant level of growth, as the permanent downshift in growth and inflation justifies lower terminal rates; and as such, borrowing costs are under no pressure to move higher.

What's more, with austerity policies being followed in many developed markets, inflation and output are hardly in a position to increase by much amid such an equilibrating outcome. There is a resistance to using the fiscal lever for softening, although an easing in the pace of consolidation is the most that can be expected. The risk going forward is that central bankers may lose their narrative of central bank omnipotence at some point, as governments will need to wake up and realise that only fiscal stimulus will likely achieve targeted growth and inflation in suffering DMs.

At the zero bound, depressed inflation expectations prevent real borrowing rates from falling low enough to generate a sustained economic recovery. The economy gets stuck in a deflationary, low-growth vicious circle. The main problem with deflation is that wages and interest rates have downside nominal rigidities that limit their ability to adjust to the right degree when general price levels are falling. It is like quicksand: once you are in, it is hard to get out and any movement may make things worse.

Minimal inflation (let alone deflation) makes it harder to pay off existing debts… DM's have pulled out all the stops to boost demand and get inflation to rise to 2% in a bid to alleviate the debt burden. This is easier said than done in most cases, however, not least because the national debts have increased so much that it is all but impossible for most governments to boost their economies through fiscal measures, so the onus is largely on central banks to boost demand. This is no soft option, either, as consumers feel they already have too much debt, and even with interest rates at 0%, they are reluctant to borrow more. Hence, surplus liquidity flows into other countries, or to the asset markets.

A combination of slowing rises in productivity and weak investment are also slowing down potential growth… Almost six years after the crisis, and with still no pickup in growth, it is becoming clearer that we are also suffering from a supply-side problem, with much slower growth in both labour supply and productivity. When the growth of potential supply is expected to lose momentum, consumption and investment weakens, setting the stage for feeble demand growth. Central banks risk creating bubbles by fighting this challenge, or face admitting weak growth of supply turning into a self-fulfilling prophecy.

Partial explanations for a weak supply-side could be listed as; (i) the crisis has left capital in all the wrong places, while greater constraints are preventing banks from aggressively helping to reallocate capital; (ii) there is little mileage left in the productivity gains brought by technology and the internet; and (iii) EM economies are not as effective in importing the economic know how from developed markets, though, owing to globalization, they add to the production capacity.

After all, the most important impact of a weak global supply side is a lower return on capital, which, coupled with the post-crisis rise in savings, pushes interest rates and discount rates down further than normal. However, fading excess capacity still requires rate normalization - just a lower normal. A flatter curve follows.

All in all, while Europe may be a better candidate for secular stagnation, the prognosis for the US economy is still somewhat debatable. Nevertheless, many of the policy implications may still be valid if the weakness turns out to be more cyclical than secular, including the need for a continued accommodative policy.

In sum, the global deleveraging cycle still has a very long way to run. With debt ratios well above historical levels in major economies, any significant rise in interest rates could clearly cause some major problems, underlining the need for any future increases to be gradual…

Competitive devaluation gathering momentum…

A global macro backdrop characterized by subpar growth and deflationary tendencies creates a strong incentive for policymakers to pursue competitive devaluations. As long as growth does not take off and central banks keep the printing presses rolling, a lot of money flows to the asset markets. This leads to appreciation pressure on the currencies in the targeted markets, which hurts their competitive advantage in foreign trade. So central banks in those countries have little choice but to open the liquidity spigots, in order to boost asset prices, prop up growth and drive down their own currency. A domino effect could ensue in a climate of stagnating domestic demand, as each country, in turn, tries to depress its currency in order to support exports and raise inflation rates.

Currency wars have just been ratcheted up a notch, as seen by the latest moves from the BoJ and the PBOC, which export deflation to the rest of the world. The BoJ stepped up its already aggressive QQE program, while the PBOC marked the beginning of a policy easing cycle. ECB President Draghi, in turn, has pushed the case for QE in Europe, ramping up the rhetoric to a "whatever it takes" level, confirming that the ECB will take control of the "size and composition" of its balance sheet with greater urgency than before. In all likelihood, central banks outside the U.S. are focusing on preventing a negative deflationary spiral.

Against this backdrop, a stronger dollar will mean the US is unlikely to be able to get rates high enough in this cycle to be able to avoid an unconventional policy again in the future. **So we still think central banks are trapped into more years of printing of money.**

Competitive devaluations are a zero-sum game. They do not add to global growth, but simply redistribute it. Also, depreciating currencies may lift domestic inflation rates, but they export deflation to the rest of the world, keeping rates "low for longer".

"Lower for longer…"

Quantitative easing has been the most important factor behind the decline in yields since the global financial crisis broke out. Looking ahead, unwinding bloated central bank balance sheets will have a gradual impact on bond yields unless policymakers aggressively sell assets. The resulting upward pressure on yields may largely be offset in the next five years if growth and/or inflation do not significantly outperform consensus expectations. Fiscal positions will generally improve in major advanced economies, while demographic trends will deteriorate further. Equilibrium long-term bond yields will only edge modestly higher in the next five years, in our view, due to the muted impact of the end of QE programs, reflecting the small extent of the flow effect on yields and that the stock of assets erodes only gradually relative to GDP.

The main factor depressing fair value yields will be demographics; a continuing slowdown in labour force growth will undermine consumer and business spending and keep real bond yields depressed through slower economic activity, lower central bank policy rates and weaker credit growth than would have otherwise occurred.

This is particularly the case in the Eurozone, where the growth in the labour force is projected to slow down to Japanese levels in the next decade. The path of the Eurozone's recovery so far resembles that of Japan in the early 1990s from a number of perspectives. The fair value bond yields in the Euro Area is likely to be flat for many years, and there is a good chance that Euro bond yields will fall to Japanese levels with the introduction of QE.

The normalization of bloated central bank balance sheets will likely have a more pronounced effect over the next decade, boosting forward yields more steeply over the period. Much depends, however, on whether governments can tame the budgetary burden presented by an ageing population.

Higher real rates; the Achilles heel for stocks …

The current term structures already discount a scenario of policy rates remaining negative in real terms over the next 5-6 years (in the US) and the next decade (in Europe and Japan). The low yield on the 10 year UST does not actually reflect a low expected rate of inflation. It does, however, reflect the very low real rates, which are driven primarily by market expectations of monetary policy (i.e. the receding market expectations of Fed hikes).

Since the crisis, equities have exhibited a negative correlation with real yields and a positive relationship with breakeven levels. Thanks to QE, lower nominal yields have facilitated higher P/E's because of the better low real yields/higher breakeven mix that has simply not existed until now. If this correlation continues, it is crucial that nominal yields normalize over time, led by higher breakevens rather than higher real yields, or at least that real yields do not rise at the expense of breakevens – which is exactly what happened in the shakeout of the markets in September.

This might suggest that risk assets are still not "ready" for normalization - and at any rate, the Fed will be well advised to pause after an initial lift-off, to ascertain the ability of markets to withstand higher rates. So equities may well be able to sustain their gains under an accommodative Fed and rising inflation expectations, but it is pretty clear that earnings alone should not be the sole driver of valuations, nor indeed nominal yields, without reference to the mix.

'Lowflation'

Despite generally stronger growth, inflation is likely to remain well below the target levels almost everywhere. The basic economic reason is that the global economy retains plenty of slack, visible in the labour markets (wage pressure being slow to return) and in the oil market, where an over-supply will keep prices reined in, adding to disinflationary pressures in the global economy. This gives rise to negative rates, asset purchases and FX interventions.

Low inflation to keep global monetary policy very easy. The silver lining of the plunge in commodity prices and wave of global deflation is that although the Fed and the BoE may start normalising short-term rates in the latter part of 2015, the risk is on the side of even later hikes and the initial pace is in any case likely to be slow. In the Euro area, the probability of sovereign QE has risen significantly as inflation remains well below the target and the ECB is pursuing a sizable increase in its balance sheet, which may be difficult to achieve without government bond purchases.

Central Bank Watch

A little pain before some (Fed) gain?

The binding constraint for the Fed is shifting away from labour market slack towards nascent weakness in inflation expectations… On its own, the U.S. labour market would justify a much more aggressive path for the fed funds rate. However, global deflationary pressures are filtering into the U.S. in the form of a stronger dollar as other central banks absorb more duration. With inflation at around 1.5 per cent, according to Fed's preferred measure, policy makers are not likely to raise interest rates, even if the economy approaches full employment. US inflation would naturally come down the most in a "weaker commodities - stronger dollar" scenario compared to the rest of the world. Inflation will remain subdued even with unemployment likely falling further in 2015. In responding to a 'dual mandate', the Fed will likely remain balanced going forward, run the economy 'hot', and pave the way for further pockets of volatility as the impending start of policy normalization approaches.

U.S. wage inflation appears to be edging higher, but from a very depressed starting point. It will be many months before wage inflation rises to a level sufficient to trigger the Fed into a rate hike, as the non-accelerating inflation rate of unemployment (NAIRU) may have declined. We will primarily be watching the Employment Cost Index (ECI) data in 1Q15 to track wage inflation. The ECI is now at 2.2% YoY and the leading indicators currently suggest a 2.3-2.4% YoY level early next year. For the sake of reference, when the Fed hiked rates in 2004, the ECI averaged 2.65%.

The BoJ's asset purchases represent a large offset to the end of Fed QE, from a global "search for yield" perspective, while ECB uncertainty is also likely to result in lower yields for the remainder of 2014 and 1Q15. We believe government bond yields outside the U.S. offer little sustainable upside until we see some positive global growth surprises. The U.S. economy cannot easily absorb a major exchange rate re-alignment, thus forcing the Treasury market to act as a shock absorber as well as a "relief valve" for dollar strength.

The Fed's reaction function could be dampened by the following hindrances, in our view:

(i) **Late-cycle dynamics:** The US recovery is over-reliant on labour inputs at the expense of productivity due to the troubling decline in the labour share of income relative to that of capital. Higher wages would considerably undermine the profit picture of U.S. companies in an environment of limited pricing power and low productivity. Hence, corporations could seek to defend margins by reducing labour input as wage pressures rise. Therefore, even if wage inflation starts to pick up and push the Fed into adopting a more hawkish posture, the Fed would have to assume a cautious approach towards tightening to prevent it from unwarrantedly undermining the economy. We therefore think that the Fed needs to be more tolerant of any rise in wages, to buy more time for investment-led productivity growth.

(ii) **Further pass-through of headline inflation into the core:** The core PCE will not reach the 2% target for at least a "few more years" in the US as the global disinflationary backdrop will remain an offset to any brewing domestic inflation pressures. A stronger dollar, lower commodity prices and downward pressure on headline inflation might spill into core inflation, potentially dampening the rate hike cycle.

(iii) **A failure of wage pressures to rise even as unemployment falls:** The response of wage inflation to declining unemployment has been muted when compared to the pre-crisis era. In a zero-rate environment marked by chronic over-saving, the Phillips Curve could be dead flat for a long time to come due to downward nominal rigidity in wages (i.e. "pent up" wage disinflation). In other words, the link between growth/unemployment and inflation would be severed by a large accumulation of excess savings. This reinforces the point that we truly do not know how much slack there actually is. As such, if the markets realise that the NAIRU has fallen on the back of the ongoing demographic trend of an ageing workforce, this could imply more slack in the economy than might otherwise have been expected, and may help explain the behaviour of inflation. A lower NAIRU of around 4.5% could eventually create scope for additional declines in the equilibrium and terminal rates.

(iv) The longer it takes for the ECB to reach an agreement and unveil how balance sheet expansion would be accomplished, the higher the probability that markets will force the issue, swinging to risk-off in an ECB disappointment trade. Thus we may have to see things getting worse first, before they can get better in the Eurozone.

In brief, unless productivity relief comes earlier, allowing wages to rise without disrupting profits, the above-mentioned dampening mechanisms could plausibly short-circuit the entire cycle, trapping the Fed at zero.

So how do we expect the Fed policy to evolve?

The FOMC “dots” imply mid-2015 may be the likely date for the first Fed rate hike; we are not so sure... The FOMC may have already decided to treat the lift-off date as quite “sticky” because it believes that this will render the first hike less disruptive, and because it plans to respond to new economic information mainly through changes in the slope of the hikes.

The Fed’s forecasts are themselves a policy tool, in our view, seeking to reduce pessimistic signalling concerning the economy. One of the Fed’s key tasks is to guide the markets to a pricing scheme whereby the actual tightening itself will cause little market reaction. As such, the Fed clearly wants to avoid forming bubbles; hence its balancing act is to reduce any froth in asset markets by increasing risk premia while avoiding the impression that a policy error is in train. Let's suppose the Fed can remove the “considerable time” phrase in an otherwise dovish FOMC statement, which may note concerns about market inflation expectations, the dollar, and the external growth environment. This would raise volatility and widen spreads, and buy time for cheaper equities as earnings grow, while re-focusing markets on incoming data. In due course, the Fed could square the circle by delaying rate hikes into 2016 by “failing” to meet (i.e. rolling forward) the 2015 “dots” rather than pre-announcing a delay, buying time for productivity relief and a more robust profits picture. This would re-compress risk premia. Speculative shorts would eventually be squeezed and carry trades would prosper at the front end, as actual market rates converge with the current market expectations rather than the FOMC’s current guidance path.

The old adage, "don't fight the Fed," may be joined by a new one; "don't fear the Fed…" Even though the Fed can deliberately engineer volatility like this on the back of improvement in labour market momentum, we would expect FOMC members to err more on the side of caution and wait, as a premature start to tightening could turn into a spectacular own goal, given the risk of disin(de)flation. This is driven by our view that profits are vulnerable given low pricing power and feeble productivity growth, and that risk markets are not yet ready for higher real yields. The implication is that we could see another bout of turbulence and spread widening similar to that seen in October, before the FOMC capitulates into moving to a later lift-off date. While the risk of another flaring up in risk aversion is fairly significant, the global savings glut and search-for-yields argue in favour of continuing to pick up carry, as Fed rate hikes will have to be gradual and smaller in magnitude than in past cycles, through the message of a very slow upward rate trajectory, with longer pauses to refresh and ascertain the effect of the tightening policy on risk assets.

How much dollar appreciation can the U.S. economy stand?

It is hard to argue against the consensus that the dollar will move higher under the current stance of the G3 central banks. There is the risk that expectations of a stronger dollar are self-defeating, however, as greenback strength would nip away at U.S. growth and likely delay the timing of a Fed rate hike. A stronger dollar only imports extra deflation risk into the US, leading to bull steepening. In the case of stronger global demand, a stronger dollar would export inflation, leading to bull flattening - either case feeding the “low for longer” theme. Further USD upside would also be constrained by stretched positioning, a wide current account deficit and the prospect that the Fed would be unable to raise rates as aggressively as the “dots” suggest.

The dollar has the potential to alter the course of Fed policy in the current cycle. The tightening in monetary conditions has almost always occurred as a result of higher interest rates in the U.S. The USD has tended to be flat-to-lower in almost every Fed tightening cycle since 1990. The FOMC might be almost a year away from the next rate hike cycle, but the dollar's 7% appreciation in trade-weighted terms since the beginning of the year has already tightened monetary conditions by about 70bps. In other words, the dollar's rise has the same effect on the economy as a 70bps Fed rate hike. As mentioned earlier, the bond market is a key relief valve in offsetting the deflationary impact of a strong dollar, and if the dollar is in a bull market, it usually supports bonds and keeps monetary tightening at bay. Of course, it is possible that both the dollar and bond yields rise simultaneously and strongly, but that would require the U.S. economy to grow at a rate sustainably above trend, probably at around 3.5%, something which is not especially likely for some time to come.

Terminal fed funds rate to remain below pre-crisis levels

Even after the scars of the financial crisis have healed, the fed funds rate is almost certain to remain below pre-crisis levels, as demand will suffer from weak labour force growth and the lack of a new re-leveraging cycle. Unless productivity is zooming ahead when the US hits full employment and inflation has hit the target, jobs growth is likely to slow down significantly. This implies that to maintain full employment, the Fed will need to keep rates much lower than in the past. **We believe that the neutral funds rate will be 3% or less in this cycle, so just one percentage point - or less - in real terms over the rate of inflation.**

The average real fed funds rate during successive business cycles has trended lower over the past 35 years. The rate averaged only 1% during the 2001-07 business cycle, a period in which potential growth was faster than it is today and demand was being buoyed by the housing reflation, rising debt, a falling dollar, strong EM growth, and the fiscal stimulus. If a 1% real rate was broadly consistent with full employment back then, it stands to reason that the neutral real rate is even lower today.

In concrete terms, this means that the market believes the Fed will hike - but will then soon find that the economy can't handle a rate much above 2%, given the low return on capital, forcing the FOMC to end rate hikes at a point well below what their "dots" currently project. Expectations of low eventual policy rates should force the US curve to flatten dramatically after the first few rate hikes. **This should maintain the "sweet spot" for carry-driven fixed income strategies in the absence of major interest rate volatility.**

The ECB: less aggressive than the markets are pricing in…

A Eurozone in a fiscal trap… The IMF has ascribed as much as a 40% risk of recession in the Euro-area, which would be the third since 2008 if it happens. Just like Japan in the 1990s, the euro area may be caught in a fiscal trap in which government debt levels are destined to rise further amidst feeble growth and lower potential GDP. If this were to happen, solvency worries would resurface, ultimately setting the stage for another major crisis. The ECB has the tools at hand to deal with liquidity issues facing European governments, but not with solvency problems. Although improbable, another sovereign default in the euro area over the next five years cannot be ruled out, in our view.

Germany thinks it makes little sense to apply monetary and/or fiscal stimulus until extensive reforms have taken place. Many ECB members also believe that applying a macroeconomic stimulus is like carrying coals to Newcastle; at least, that is, without needed structural reforms. What's more, if the central bank gives in to pressure and opens the monetary spigots, numerous European politicians will take this as an excuse to delay the unpopular structural reforms.

The mounting competition from emerging markets and an ageing European population are presenting a great challenge to the generation of economic growth in the continent. In the absence of substantial structural reforms, there is every chance that growth will remain low and deflation looms ever larger with lacklustre credit flow, lower commodity prices, and falling inflation expectations. The toxic mix of high debts and deflation could be 'lethal' for the economy; hence the need for urgent action.

The wrong fiscal policy setting... As the entire Eurozone economy is struggling with an acute case of underinvestment or over-saving, the most effective policy remedy could have been for the public sector to reverse tightening, and to do so aggressively. The unfortunate reality is that most European governments remain on an austerity path, which means the public sector is adding even more savings to a system that is already awash with excess savings. The inevitable economic adjustment is for output to contract or for prices to fall, or some combination of the two.

Against this backdrop, the ECB can ill afford to "play a waiting game" until structural reforms are in evidence in many countries before it starts to boost the economy monetarily, or it will risk a negative deflationary spiral. Falling behind the curve could also cause tensions to flare up in the Eurozone, with capital flowing out of the periphery and the gap between the Northern and Southern blocks widening, until a crisis erupts.

The ECB is not trying to create an upward economic spiral. Instead, it just wants to prevent a downward deflationary spiral. If it were to do more, the member states could be tempted to postpone the much-needed structural reforms. Hence, we expect an ECB policy that will certainly help prevent excessive economic weakness and deflation but without generating substantial economic growth in Europe. The ECB is more likely to end up relying on negative interest rates to drive down the currency and indirectly thereby support growth.

The latest BoJ stimulus and the PBOC rate cut have piled pressure on the ECB to implement new measures… The ECB may have difficulty in proceeding with massive sovereign bond purchases without Germany's blessing. Still, the yen's decline against the euro puts additional pressure on ECB policymakers to act sooner rather than later, as the Eurozone economy is still being suffocated by deflationary pressures. We are also very sceptical on the ability of the policy measures announced so far to generate the desired balance sheet expansion (EUR1.0trn), even over a 3-year period. The majority of the increase in the size of the ECB's balance sheet can be achieved via asset purchases, in our view, and the only credible way to achieve this is via the purchasing of Euro area sovereign debt.

The ECB is behind the curve, in our view

The ECB will be forced to embrace full-scale QE… Perhaps more economic pain and actual price deflation are what is needed to relax Germany's objection to QE and further fiscal stimulus. But the longer the action is delayed, the more extreme the policy response will have to be. Although the ECB may be reluctant to act before it feels other options are fully exhausted, it will actually have to put its money where its mouth is by firing up the printing presses. After all, Draghi still commands a majority in the Governing Council (GC) whatever Germany wishes, and he has already paved the way for sovereign QE - so that it would be in an even deeper hole if the ECB does not act.

We think there is too much discord within the ECB for a public announcement on QE in December, and that such a step is more likely in 1Q15, even though the probability is that it would be limited in scope at the outset… Listening to Draghi of late, we feel the hurdle for sovereign QE is getting lower than even our fairly dovish expectations; but the ECB President seems to be running ahead of the GC consensus. Draghi identified two scenarios or contingencies in which the ECB will act: (i) the ECB concludes that the current measures are insufficient to reach the EUR1.0trn goal; or (ii) the medium-term outlook for inflation deteriorates. The first contingency will not be triggered by this week's meeting, as we would expect the GC to be aware of how successful the second TLTRO was on December 11th before announcing further material policy initiatives. Also, the ABS purchasing programme will have only been operating for two weeks, hardly enough time to judge the programme's effectiveness by December 4th. Regarding the second contingency, staff forecasts are also unlikely to trigger a policy response yet, even though their views on growth and inflation will likely be revised down.

Hence, the ECB may get a free pass until the New Year, even though we still see the potential for something to be pulled forward to this week's meeting to fulfil heightened market expectations (e.g. a pre-announcement of corporate bond purchases). While we do not expect sovereign QE to be announced as yet, potential risk-off from an ECB disappoint this week could be relatively small as expectations will be kept alive with Draghi maintaining as dovish a stance as possible at the press conference. Yet, if the elements of his 'dovish' 21 November speech do not appear in the prepared press statement, the market may worry that the GC is more hesitant and Draghi's dovishness is being reeled in again, just as it was in October.

Political hurdles and a lack of clarity on modalities of balance sheet growth could leave markets prone to swings from risk-on to risk-off at times, but tighter spreads win out in the end while the cycle is ongoing towards what might be described as a 2-step forward, 1-step back market.

All in all, we are reluctant to give up the carry at a time when the ECB has promised to expand its balance sheet. Bond yields in Europe are likely to match Japanese levels when the ECB announces a large-scale asset purchase (LSAP) program. We envisage the LSAP exerting more downward pressure on European interest rates than the Fed's QE has exerted on US rates, because of the negative deposit rates in the EU. When the ECB buys bonds from banks, the latter will want to use those funds immediately to avoid the penalty interest rates on deposit accounts at the ECB. We do not expect any significant pick up in credit activity; hence many banks will either park the surplus money in bonds, virtually irrespective of the yield, or lend it outside the Eurozone. Even though ECB purchases may or may not include peripheral sovereign debt, all spread products will benefit from the withdrawal of duration from the Eurozone bond market.

To the extent that the ECB succeeds in bringing the euro lower, the Eurozone's already massive C/A surplus is likely to grow and hence nudge European flows into other higher-yielding country assets, such as those of 'good' EMs, while rendering lower long-end yields and exceptionally flat global yield curves. If the ECB is unable to expand its balance sheet sufficiently to weaken the euro on the margins, inflation expectations may again continue to fall, further pressurising core yields downward, which is also likely to be an incremental positive for flows into EMs.

Japan ups the ante…

For the Japanese economy to emerge from recession, purchasing power should improve, preferably as a result of higher pay rises, and Japanese consumers should be persuaded to spend more in different ways. Either the budget deficit needs to widen and/or asset prices should continue to rise in order to persuade households to borrow more. To put it another way, both monetary and fiscal policy are set to ease further.

The financial markets are assuming that the Japanese budget deficit will not narrow in the near future. Whereas this would normally put upward pressure on interest rates, the Bank of Japan (BoJ) is expected to purchase enough bonds to offset this pressure. Should PM Abe manage to get enough votes in the snap election to implement reforms, and if we see some stirring in wage inflation, it may be possible for the BoJ to ease the take its foot off the monetary gas, propping up the yen for a while. In the long term, however, the yen will still probably remain very weak with the following implications:

- The BoJ will be removing even more duration from the JGB market, representing a large offset to the end of Fed QE from a global "search for yield" perspective.
- Other central banks (such as the PBOC and the ECB), will be under pressure to lean against any strength in their currencies. The ECB will need to soak up duration at a faster pace.
- The central banks of several EM countries with large USD-denominated debts may have to tighten monetary policy in a bid to curtail local currency depreciation. This implies even more global savings in search of a home.

China: from "the workshop of the world" to the "investor in the world"…

We consider China to be in a slow decelerating trend, with risks of a sharper correction, though on balance, we expect the authorities to avoid a hard landing - although the country may be weaker than it looks. Beijing is trying to reduce the dependence of its economy on exports and investment. Instead, it is seeking to generate growth through higher consumption. Owing to this transformation, growth is set to be constrained in a 5%-7% band for a prolonged period to come. To this end, a very loose monetary policy was applied for years - and it has now resulted in too much debt. A cheaper domestic currency could help the Chinese export sector to some extent, but a credit bubble would be disastrous for the Chinese economy. Hence, the Central Bank of China (PBoC) is exercising caution in opening the liquidity spigots to drive down the yuan.

After the BoJ announced a step up of its QQE program, however, the policy stance has changed from marginally loose toward broad-based easing, with the PBOC cutting rates and marking the beginning of a policy easing cycle that should last throughout 2015. This may still be limited in scope, though, as it was meant to prevent rapid deleveraging, not to increase indebtedness. The long running appreciation in the yuan, which has continued for some years, may therefore come to a pause, as it did during 2008-2010, but a sustained depreciation is also unlikely, which will not help correcting any C/A surpluses.

As the pace of investment slows, China is likely to generate many large current account surpluses to come, in our view, which will transform it from being "the workshop of the world" to being the "the investor in the world". The upward pressure on global savings emanating from China is in fact evident in its surging trade balance, despite lacklustre exports. The result is more Chinese purchases of U.S. Treasuries and bonds in other advanced economies. Consequently, **we feel the scale of capital outflow from China could be so large that it may keep long-term capital cheap, even if the world's major central banks tighten their monetary policies.**