PREDICTIONS 2016

STAIRWAY TO HEAVEN, HIGHWAY TO HELL

BREAKINGVIEWS

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INTRODUCTION

It's the end of the world as we know it – or at least as we've known it for the past seven years. The money for nothing that fueled government spending, emerging markets and the allure of risky financial assets will start going the way of disco in 2016 as the U.S. Federal Reserve raises interest rates. For nations and corporations with strong balance sheets, it could be a welcome shift – even a stairway to heaven. For overvalued businesses, profligate governments and high-yield markets, danger lies ahead – perhaps a highway to hell.

That's the theme of Reuters Breakingviews' Predictions 2016, a collection of financial insight aimed at giving readers a jump on the year ahead. If the past is any indication, many of the pieces will be pitch-perfect. A year ago we said Deutsche Bank would oust its leaders and accounting fraud would become a top regulatory priority. Bingo. But we also forecast oil at $80 a barrel and a cooling mergers and acquisitions market. Right or wrong, our goal is to offer intelligent and provocative ideas in our typically pithy format.

This year's book is divided into four classic rock-inspired sections: The Thrill Is Gone, Anticipation, A Hard Rain's A-Gonna Fall and Won't Get Fooled Again. In the first category, we are doubling down on our view that mergers and acquisitions have peaked in America. Also look for oil-rich nations like Saudi Arabia to start raiding sovereign wealth funds to pay for social stability.

Musician Robert Plant (R), lead singer of British rock band Led Zeppelin, performs during the 13th Mawazine World Rhythms International Music Festival in Rabat June 5, 2014. REUTERS/Youssef Boudlal

A new U.S. president will take office just in time to battle the first recession since the financial crisis, and old-school interest rate indicators make a revival as the Fed raises rates again. Quarterly reporting will get a rethink – a prediction British insurer Legal & General just proved true. Activist investors will roam again and may move the earth under U.S. machinery maker Caterpillar.

Many nations and companies will be judged on how well they anticipate challenges in the new monetary environment. Brazil's economy will probably get worse before getting better, but the rule of law should help the nation emerge stronger from its crisis. China will allow Facebook to re-enter the Middle Kingdom, and entertainment juggernaut Walt Disney will rocket higher with the Star Wars franchise. Meanwhile, prudent banks will spend the year preparing thoroughly for Britain's possible exit from the European Union.

Tough times are ahead for the likes of Valeant Pharmaceuticals and other corporate rollups that padded profit with cheap money and financial engineering. The overall earnings of U.S. companies will take a hit from competition, disruption and tax policy after accounting for a historically high share of economic output.

Elsewhere, big energy companies will scramble to account for decades of downplaying climate concerns. And lousy governance could force wrenching changes in the boardrooms of Volkswagen and Glencore.

Anyone who vows not to get fooled again almost certainly will. A world hunkering down for more sub-$50 a barrel oil will breathe a sigh of relief as the price rises – wait for it – past $80. Media moguls who once considered Netflix an ally will come to view the video-streaming service as a villain, and companies will probably regret some of the self-aggrandizing titles they splashed on the covers of their annual reports. Even the Fed, having confidently raised interest rates, may wind up having to cut them again as 2016 draws to a close.

We also have predictions about Prada, HSBC, Argentina and other topics. And if you want to know what country will bring home the most medals from this summer's Olympics in Rio de Janeiro, check out our calculator.

Prescient but imperfect, and with dated taste in music, we nonetheless promise to cover the coming year with the clarity, speed and insight that you expect. Join us now for a glimpse of the near future. Stick around to see how it all turns out.

Reynolds Holding
Law editor, Reuters Breakingviews
Jan. 4, 2016

REUTERS

THE THRILL IS GONE

FED LIFTOFF WILL REINVIGORATE KEY MARKET GAUGES

BY RICHARD BEALES

As the Federal Reserve starts exercising some atrophied muscles, traders will have to relearn their craft, too. The U.S. central bank is getting used to the idea of lifting rates above zero for the first time in seven years. That will reinvigorate some old-school market gauges. People used to watch fed funds futures, Eurodollar derivatives and a clutch of traded measures of inflation like hawks (or doves). These indicators are due fresh attention – even if their meaning has morphed.

The Fed guessing game will intensify as traders make bets on what Chair Janet Yellen and her colleagues will do at each of 2016's eight monetary policy meetings. Fed funds futures, nowadays helpfully analyzed on the CME's FedWatch web pages, provide a market-implied trajectory for overnight interest rates in the near term.

There are wrinkles in the post-financial crisis world, though. For instance, if the Fed sticks to a range for the fed funds rate rather than a specific level – the official target for seven years has been between zero and 0.25 percent – it makes the meaning of futures prices fuzzier because calculating implied probabilities of Fed moves requires assumptions about exact target rates.

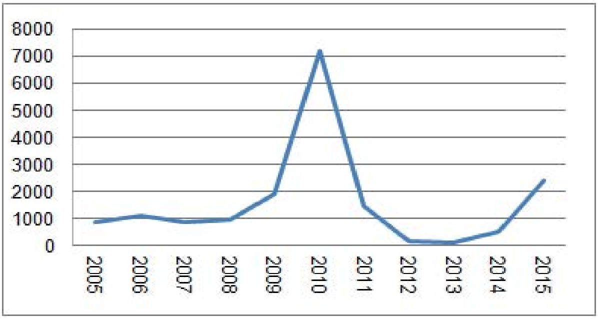
More broadly, financial markets have changed since before the financial crisis. Banks must hold more capital and they face other regulatory constraints, while central bank balance sheets have expanded dramatically – the Fed's has swollen to $4.5 trillion from under $1 trillion in early 2008.

Such effects could create new distortions relating to inventory levels, market liquidity and trading norms. That's even more significant for other tools like overnight indexed swap (OIS) rates and Eurodollar futures. Using Eurodollar futures, for instance, to glean the market's view of the longer-term path of Fed policy involves estimating the so-called basis, or gap,

Ghost of fed funds future

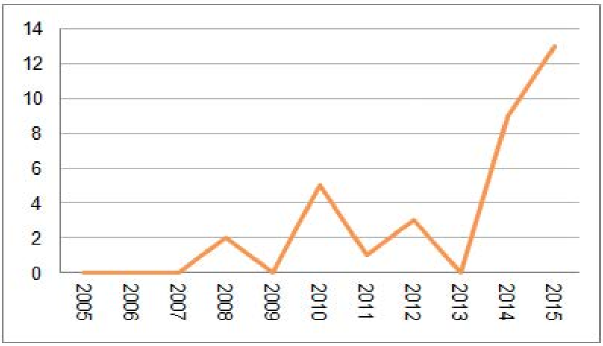
News articles featuring Fed buzzwords

Fed funds futures
Derivative contracts whose prices are based on the expected Federal Reserve policy interest rate in a future period.



PCE inflation
Price increases derived from data on personal consumption expenditures, a key U.S. measure of consumer spending.

5 year 5 year forwards
A market measure of expected inflation over five years starting five years from now, derived from Treasury securities trading prices.



Source: Factiva. REUTERS/Richard Beales and Katrina Hamlin between Libor and fed funds rates. Pre-crisis rules of thumb may prove way off.

Fed-watchers will also eventually need to track inflation again. Statistical estimates, even those aiming to exclude energy costs, could be suppressed by recent low oil and commodity prices. Financial measures, like breakeven rates on U.S. Treasury inflation-protected securities or TIPS, may suffer from the same post-crisis market distortions.

Traditional navigational instruments may still point in the right directions, but traders feeling out how they now relate to each other could cause a few market fender benders in the year to come.

Published December 2015

TWO SIGNS OF M&A BACCHANAL'S LAST HURRAH

BY ROB COX

Pfizer's $160 billion takeover of Allergan marked a few milestones in the mergers and acquisitions trade. It was the top deal of the year, exceeding Anheuser-Busch InBev's purchase of SABMiller, and by some measures is the second biggest in history. The all-stock transaction also vaulted the total value of corporate dealmaking in 2015 beyond the record set in 2007, just before the financial crisis shuddered things to a halt.

The pharmaceuticals union also printed another, more dubious superlative as one of the largest deals ever predicated on exploiting global tax loopholes. Without the ability for Pfizer, the larger of the two companies, to back its way into Allergan's lower-tax Irish domicile, the maker of Viagra, Lyrica and other sweet-sounding compounds would have incinerated some $17 billion of shareholder treasure.

That this high-water mark of M&A is justified by its tax workaround would be sign enough that the two-year boom of extraordinary corporate promiscuity is reaching its logical conclusion. Other, perhaps less perceptible, warning bells are clanging, too, which suggest companies are increasingly pursuing financial engineering to fix troubled core businesses, a trend that in previous booms has ended poorly for investors.

Spectators are silhouetted as they watch Italy's fireworks during the 6th World Pyrotechnics Olympics in Manila Feb. 14, 2015. REUTERS/Romeo Ranoco

The desire of companies to band together and reduce overlapping costs won't diminish any time soon, particularly as the prospects for global economic growth look mediocre at best. Thanks to Pfizer's combination with Allergan, the value of worldwide announced M&A reached $4.2 trillion in 2015, according to data compiled by Thomson Reuters, up from around $3.5 trillion in 2014, and surpassing the record achieved eight years earlier.

Pfizer isn't the first healthcare company to take advantage of a so-called inversion, wherein it merges with a rival based outside the United States to reduce the overall tax burden in ways that enhance the bottom line. Pfizer's is, however, far and away the biggest on record: The drugmaker led by Ian Read is expected to save $1.7 billion in payments to the tax man by 2018, according to an analysis of the deal by my colleague Rob Cyran.

What's more, Pfizer's inversion is larger than the previous 10 such deals in the industry combined. That includes the $66 billion merger with Actavis that created Allergan earlier in 2015. Together, those transactions add up to around $140 billion in value, Thomson Reuters data show.

At least Pfizer can justify the expenditure on Allergan using arithmetic, however illusory the savings may turn out to be if the U.S. government modifies its tax code in the next couple of years. A handful of smaller takeovers, unveiled in the days leading to Pfizer's big one, are harder to fathom, and point to an anecdotal spate of distracted dealmaking that is often emblematic of a peak in the M&A business.

Take the case of Urban Outfitters, the $2.9 billion apparel retailer, buying a pizza chain. Its acquisition of The Vetri Family group of restaurants is guided by the notion that Urban Outfitters, which also operates the Anthropologie brand, can increase foot traffic to its stores by selling customers food and beverages alongside scarves and underpants. According to Urban Outfitters Chief Executive Richard Hayne: "Spending on casual dining is expanding rapidly, and thus, we believe there is tremendous opportunity to expand the Pizzeria Vetri concept."

While consumers may be spending more on mozzarella than denim, it's a clear instance of strategic shift for a fashion company in trouble. Urban Outfitters shares have lost more than a third of their value this year. Its third-quarter sales, released shortly after the pizza purchase, came in shy of what analysts had been expecting and its same-store sales barely budged from the year before.

Pandora, the $3 billion music-streaming pioneer, is another example of a company reverting to M&A to stray beyond its challenged main operations. Like Urban Outfitters, the market has not been kind to Pandora shareholders, who are down some 20 percent on their investment year to date. It's not usually a show of confidence, however, that the company has been buying assets in so-called "adjacent" businesses to its own.

On the same day Urban Outfitters got into the pizza game, Pandora agreed to pay $75 million for some technology and intellectual property assets of Rdio, a rival service of sorts that filed for bankruptcy. The deal, coming after a profit-warning shocker and an earlier move into the "adjacency" of live music ticket sales with the $450 million purchase of Ticketfly, further unnerved shareholders.

Pandora's boss Brian McAndrews described the deals as "defining the next chapter of Pandora's growth story." The implication, however, is that Pandora's current chapter is over. ConAgra, meanwhile, has already started and ended a new phase within this very deal cycle. It disastrously tried to marry its branded consumer goods like Chef Boyardee with the white-label Ralcorp. Some two years after paying $5.1 billion for the business, it agreed in November to offload it to TreeHouse Foods for $2.7 billion.

Earlier eras experienced similar adjacency calamities. Nokia got into mapping software with Navteq, paying $8.1 billion in 2007 and offloading it in 2015 for $5 billion less. In a previous boom, Germany's Daimler spectacularly failed to combine its luxury car know-how with the mass-market Chrysler. And the AOL-Time Warner combo of that vintage still stands as the mother of all mission drifts.

As such deals increasingly characterize the latest M&A bacchanal – along with those where clever financial structures overwhelm strategic logic – it presents strong evidence of a last hurrah.

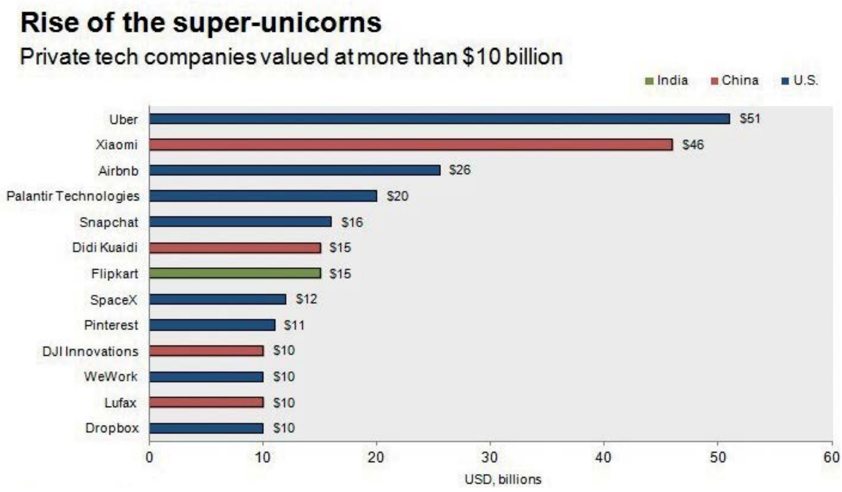
Published December 2015

U.S., CHINESE UNICORNS WILL BOLT IN OPPOSITE WAYS

BY ROBYN MAK

A fall in tech valuations may send U.S. and Chinese unicorns running in different directions. Several private Silicon Valley firms worth $1 billion or more have taken valuation hits once they are in the public eye. The same may be happening to one-horned beasts in the People's Republic, only in private.

Take Jack Dorsey's U.S. online payments outfit, Square. The shares popped enthusiastically on the company's stock market debut in November, but its market capitalization remains about a third below the $6 billion price tag implied by an earlier private funding round. Some unicorns that have yet to go public are already feeling the chill. Fidelity Investments, a prominent investor in late-stage private financings, recently marked down its holding in Snapchat by 25 percent from a headline valuation of $16 billion in May.



Source: CB Insights. REUTERS/Robyn Mak

Super-unicorns such as Uber and Airbnb, valued at roughly $50 billion and $25 billion, respectively, on the strength of relatively small private fundraising exercises, can still tap Fidelity, T. Rowe Price and others for funds. These investors may be more cautious than they were, but it’s a more appealing option than an initial public offering with the risk of a very public drop in valuation.

Of the four unicorns that have listed in 2015 only one, Shopify, floated at a mark higher than its last private price, according to data compiled by TechCrunch. Of the 14 that have gone public since 2011, half have traded down since their IPOs. Meanwhile the number of U.S. private-market unicorns continues to rise.

China’s members of the club face skepticism, too, but in pre-IPO markets. Private equity and venture capital appetites have cooled since the stock market crashed in June, with investments for October hitting $2 billion – just a third of the previous month’s total, according to Zero2IPO research, and down 30 percent year-on-year. The slowdown probably helped prompt October’s $15 billion merger deal between two group-discount website unicorns, Meituan and Dianping. And U.S.-style late-stage funding from established institutions is hard to come by.

That means many of China's startups may not have the option to stay private. They may not want to anyway, because public valuations are still high. The Nasdaq-style ChiNext board in Shenzhen trades at a whopping 80 times earnings and is up 80 percent this year. Regulators recently lifted an IPO ban, too.

Funding scares will probably cause U.S. unicorns to shy away from IPOs, but the Chinese species may run towards them.

Published December 2015

ARAB SOVEREIGN WEALTH FUND EXODUS JUST BEGINNING

BY ANDY CRITCHLOW

Oil-rich Gulf sheikhdoms are being forced to raid their sovereign wealth funds to shore up their budgets. With U.S. crude oil prices falling below $40 per barrel in December, they have no choice but to reach into these rainy-day savings. For now, they can hold on to some of their trophy assets, like strategic investments in Volkswagen or Barclays. But if crude prices keep tumbling, a fire sale will be hard to avoid.

During the most recent energy boom, the six members of the Gulf Cooperation Council (GCC) – including Saudi Arabia, Qatar and Kuwait – amassed sovereign funds worth more than $2.3 trillion. These assets have traditionally comprised a mix of debt and other securities, in addition to influential stakes in some of the world's biggest companies such as Glencore, VW and Barclays.

Large chunks of this cash are now being repatriated back to the region to finance widening budget deficits, which this year are expected to be in the region of 13 percent of GDP in the GCC. Should oil prices average $56 per barrel next year, then GCC states would need to liquidate some $208 billion of their overseas assets, or just below 10 percent of their sovereign fund holdings, based on a Breakingviews analysis of their fiscal break-even costs.

But if oil prices fall to $20 a barrel, as Goldman Sachs has warned, the GCC states may have to sell $494 billion worth of booty to make up the budgetary shortfalls based on forecast fiscal costs for their oil production in 2016. This is provided they maintain the lavish rates of public spending that the region's populations have become accustomed to.

At that rate of divestment these sheikhdoms – which pump about a fifth of the world's oil – would almost drain their funds entirely by 2020. The Saudi Arabian Monetary Agency, which also acts as the country's central bank, has already started to sell down some of its foreign assets, while money managers are reporting growing redemptions from other funds in the region.

Gulf rulers have so far resisted any temptation to jettison their most treasured assets, which in many cases have granted them board seats atop some of the world's leading companies. If oil keeps falling, even these investment jewels will come up for grabs.

Published December 2015

FROM CATERPILLAR AN ACTIVIST BUTTERFLY MAY HATCH

BY ROB COX

Caterpillar, the $39 billion maker of machines that dig mines and lay asphalt, is ready for a metamorphosis. Daft deals hatched at the height of the commodities and Chinese investment booms have trashed the company's stock and damaged the credibility of its management. An investor seeking change, potentially a breakup of the conglomerate, could play well on Wall Street, if not in Peoria.

The company led by Chief Executive Doug Oberhelman emits the kind of pheromones that attract pushy investors like Nelson Peltz, whose Trian recently bought a stake in General Electric. Caterpillar has no single large shareholder, making it easy for an activist to creep into the capital structure and make a stink.

Caterpillar's executive team is also vulnerable. Five years ago, the company, based in Peoria, Illinois, struck its biggest acquisition since founder Benjamin Holt rolled out the first of his steam tractors capable of crawling, caterpillar-like, over soggy farmland. Just after taking charge of the

A Caterpillar excavator machine is seen at a work site in Detroit, Michigan Jan. 25, 2013. REUTERS/ Rebecca Cook

company that has now employed him for 40 years, Oberhelman paid $8.6 billion for Bucyrus, which makes equipment used to mine raw materials like iron ore.

The deal is fast becoming a case study in bad timing. A global commodities glut slammed Caterpillar's new customer base, and shows no sign of relenting. Anglo American, for instance, initiated a restructuring that will cull 85,000 employees. Shares of the seven big London-listed miners have halved in value this year.

Caterpillar's own stock has shed a fifth of its value since acquiring Bucyrus. The S&P 500 Index, by comparison, has gained 72 percent over the same span. And Bucyrus' main rival, Joy Global, has lost 84 percent of its market value, implying that Caterpillar has been dragged down by infesting its other world-class businesses with dangerous commodities.

Though Caterpillar is best known for its earth-moving machinery, Credit Suisse notes that the company derives 39 percent of sales and 53 percent of profit from its energy and transportation business. That division manufactures turbines and other apparatus that compete with GE, whose shares have nearly doubled since Caterpillar bought Bucyrus.

Add it all up and Caterpillar may soon find itself exposed to a new investor eager to crack open the chrysalis in search of a butterfly.

Published December 2015

EUROPE'S LEAST BAD OPTION: DITCH SCHENGEN

BY NEIL UNMACK

The least bad way to help Europe may be to dismantle Schengen. The 26-country free border zone is struggling to cope with refugees and security risks. Abolishing Schengen would be expensive, wouldn't solve migration problems and would look like a U-turn on core European Union principles. Yet it might dampen the populism that threatens Europe's economic integration.

Like the euro, the Schengen zone that enables 400 million European citizens to travel without passports has proven incapable of coping with real-world pressures. Schengen made it easier for citizens to travel and

A Syrian refugee cries while disembarking from a flooded raft on the Greek island of Lesbos, after crossing a part of the Aegean Sea from the Turkish coast, Oct. 20, 2015. REUTERS/Yannis Behrakis trade. But it lacked a proper system for protecting external borders in Greece, Italy or Eastern Europe, or a system for rehousing asylum seekers. Its loose security arrangements look naïve in an era of homeland extremist attacks, like Paris on Nov. 13.

And just like the euro, the ideal solution would be to have more Schengen, not less. That would mean policing external borders properly, sharing genuine asylum seekers equitably. It requires trust, cooperation and time. Instead, the region is going backwards: de facto, temporary borders are being erected, and there's talk of ejecting countries that can't observe Schengen rules.

Abolishing or limiting Schengen would be damaging, but it is wrong to characterise it as a disaster for the European project. It would not impair European citizens' rights to work or trade, nor stop them from holidaying. It would create costs to monitor borders and transport goods. The Dutch Association for Transport and Logistics puts the cost for Dutch hauliers at 600 million euros. Given that Dutch truckers make up about 7 percent of transports across the region, the cost could be just shy of 9 billion euros.

Some form of rowback on Schengen may become inevitable if the migration crisis can't be tackled. Yet it would have some benefits. Chief among them is addressing the populist rhetoric in France, the UK and Eastern Europe that sees any migration as a threat. British anti-Europeans, already outside of Schengen, may welcome signs that the region can police itself, and thereafter be more open to the other benefits of the union. Sure, showing one's passport when crossing the EU is a drag, but worth it if the alternative is having no EU to cross in the first place.

Published December 2015

GIANTS OF CENTRAL BANKING WILL BE CUT DOWN TO SIZE

BY SWAHA PATTANAIK

Central bankers were the next best thing to superheroes during the financial and euro zone crises. But after rescuing banks, markets and even countries, they have finally encountered their kryptonite: consumer prices.

Inflation has refused to materialise despite the most unorthodox efforts of the most influential rate-setters. U.S. Federal Reserve Chair Janet Yellen, European Central Bank President Mario Draghi and others in the Group of Seven industrial nations slashed policy rates to record lows and together bought financial assets worth more than $10 trillion – roughly equivalent to the combined currency reserves of all the world's central banks.

Economic activity has picked up but consumer prices are proving recalcitrant. G7 inflation averaged less than 0.2 percent in the first 10 months of 2015, OECD data shows.

Worse still, central bankers' power to bend markets to their will is waning, reducing their ability to weaken currencies and thus make imports more expensive. Draghi's old nickname of Super Mario looked less apt after his Dec. 3 policy easing had the perverse effect of pushing the euro and bond yields up sharply rather than down.

Time to deploy other policy levers. First, governments could start gently reversing half a decade of fiscal policy tightening. The mostly rich OECD countries will in 2015 run a structural deficit – that is, one which strips out the effect of economic swings – of 2.5 percent of potential GDP, the lowest in a decade and a half, the international organisation says. Voters' austerity fatigue and circumstances such as Europe's migrant crisis and security concerns all suggest some slippage ahead.

Second, pay could do with rising faster. In 2014, real average wages in the OECD rose 0.2 percent, less than a fifth of the average annual increase seen between 2000 and 2007. Politicians are already thinking along these lines. Japanese Prime Minister Shinzo Abe plans to raise the national minimum wage by 3 percent each year from the next fiscal year, and the UK wage floor is due to rise more rapidly in the coming years.

Even fiscal and wage measures might fail. Further falls in oil prices or a Chinese currency depreciation could counteract their inflationary impact. But that shouldn't stop politicians from using what powers they have – especially now central bankers are proving helpless.

Published December 2015

ARGENTINA AND ELLIOTT GIVE PEACE A CHANCE IN 2016

BY REYNOLDS HOLDING AND MARTIN LANGFIELD

Argentina and Elliott Management will finally give peace a chance in 2016. There may never be a better time for Latin America's third-largest economy and Paul Singer's hedge fund to end a 14-year standoff over defaulted bonds. New President Mauricio Macri needs access to global credit markets to implement his economic plan, and another defiant Peronist like predecessor Cristina Fernandez could take over if he fails.

An Elliott affiliate has sought repayment of the bonds since Argentina's 2001 default. It and other investors refused to swap them for discounted debt in 2005 and 2010, and in 2012 won a court order saying creditors that accepted the exchange could not be paid first. Argentina protested mightily, even appealing to the U.S. Supreme Court, but to no avail.

Obstinance has come at a high price. The nation faces double-digit inflation, dwindling foreign reserves and a gaping fiscal deficit. The economy will grow just 0.4 percent in 2015 and shrink 0.7 percent in 2016,

Argentina's president-elect Mauricio Macri smiles during a news conference in Buenos Aires, Argentina, Nov. 23, 2015. REUTERS/Enrique Marcarian the International Monetary Fund forecast in October. A settlement with the holdouts, owed up to $15 billion, could reopen sources of foreign capital and help reboot growth.

A resolution is far less urgent for Elliott, considering its total sovereign debt holdings are a tiny fraction of its more than $27 billion of assets under management. Yet the expense of battling for repayment is mounting, and the firm is eager for a return on its investment.

Fernandez called the holdout bondholders "vultures." But just before his Dec. 10 inauguration, Macri sent an emissary to meet the court-appointed mediator in the dispute. Though the shape of any deal is unclear, it would surely exceed the less than 30 cents on the dollar offered in the 2010 exchange.

The trick for Macri will be getting any deal through a left-leaning Congress, where he might be able to bargain with, among others, pragmatic Peronists not loyal to Fernandez. If the new president can't fix the economy, his administration could quickly founder. A far less amenable counterparty might then succeed him – maybe even Fernandez herself, who could try to return in 2019. That alone should persuade Elliott and Argentina that further stalemate is pointless.

Published December 2015

QUARTERLY REPORTING TO GET A MAJOR RETHINK

BY ROB COX

Quarterly capitalism has become a four-letter word. From BlackRock boss Larry Fink to American Democratic presidential contender Hillary Clinton, critics of the overweening desire to hit the numbers every three months, common among both investors and managers of publicly traded companies, see a fundamental flaw in today's system. But words are cheap. For the system to change, significant players have to make the first move. That may happen in the year ahead.

Corporate executives have long railed against the treadmill of reporting their guts out every three months. They say it's a waste of time, costs money, and is a distraction from the more important tasks of setting strategy and running a business. They moan that it creates unnecessary and unhelpful swings in stock prices and debt funding costs and, most damaging of all, hinders longer-term planning.

Defenders of the practice do not say they need news flow to trade, or that trading is fun and profitable. They talk about transparency. Stock-market investors who have regular glimpses into corporate finances are better placed to judge the progress of strategy, assess the efficacy of management and gauge product cycles. The ultimate investors – widows, retirees, teachers and billionaires – gain from the knowledge.

This logic has led to mandatory quarterly reports for companies with securities regulated by the U.S. Securities and Exchange Commission. For the last three decades, the instinct to tell more, and more frequently, has gone global.

Laurence Fink, chairman and CEO of BlackRock, gestures at the session "The Global Economic Outlook" in the Swiss mountain resort of Davos Jan. 24, 2015. REUTERS/Ruben Sprich

Germany's Deutsche Boerse requires companies to provide detailed statements every quarter. Even where such regularity of reporting is no longer required – as in the United Kingdom since 2014 – it is still the convention.

But the trend may be reversing. This past summer, UK insurer Legal & General's $1 trillion investment-management arm nudged the debate forward when it wrote a letter to the top 350 companies on the London Stock Exchange urging them to consider dropping quarterly reporting.

"Reducing the time spent on reporting that adds little to the business," Legal & General Investment Management Chief Executive Mark Zinkula wrote, "can lead to more articulation of business strategies, market dynamics and innovation drivers, which are linked to key metrics that drive business performance and long-term shareholder value."

While lots of stewards of other people's money agree in principle, in practice many still worry that any company that only gives its investors a look into the sausage factory every six months will be stigmatized in the markets. Classically, this would manifest itself as a valuation discount to peers. It's worth noting that Legal & General itself still provides interim management statements every quarter.

The world's largest public fund managers and insurers could help change habits by firmly stepping off the quarterly treadmill, at least where the law currently allows. After all, shareholders set the theoretical transparency discount by deciding what shares to purchase and at what price. Ultimately, these human beings determine valuations.

If the custodians of trillions of dollars of assets decide what's good for the goose (ending quarterly reporting by the parent) is also good for the gander (the portfolio managers they employ) then other companies in other industries can follow suit. Ten of the largest listed investment managers – including BlackRock, Allianz, State Street and Bank of New York – oversee some $10 trillion of wealth.

There will be resistance. Not every investor buys the argument that quarterly reporting is a bad thing. It may help avoid problems earlier, before they fester – giving shareholders time to get out or press CEOs to fix matters more rapidly. And businesses in technology, retailing, consumer goods and media probably move too swiftly for six-month updates to be sufficient.

The quarterly-financial-industrial complex won't like a big shift, either. Stock exchanges like Deutsche Boerse and Nasdaq benefit from companies reporting twice as often in a given year, as it bolsters trading volumes and fills their faster-growing "market data" business pipelines.

More frequent corporate dispatches are arguably better for the news and information business, too, including Breakingviews parent Thomson Reuters. It even benefits Warren Buffett, who has often lamented short-termism in the investing world. Berkshire Hathaway owns Business Wire, which would see its volume of earnings reports cut if the world moved to report twice a year.

It will take a brave and big investment manager to get beyond these entrenched interests and sustained effort will be needed to modify rules requiring disclosure four times a year. But if the signals from fund managers with the most at stake are genuine, expect their corporate parents to lead the way in the not so distant future.

Published November 2015

RECESSION PROBABLY AWAITS NEXT WHITE HOUSE CHIEF

BY DANIEL INDIVIGLIO

More than just a nice desk in the Oval Office awaits the next U.S. president. Whoever wins the campaign will probably contend with an economic recession, no matter what the Federal Reserve does with interest rates. The great downturn ended six years ago, longer than it traditionally takes for another slowdown to hit. Given the sluggish recovery, another peak could be years off. But unless modern records are shattered, today's White House contenders will need to brace for a crisis.

Since the Great Depression, the average period between the end of one American recession and the start of another has been about five years. By that metric, the economy is currently operating on borrowed time. It has been more than a year longer than that average since the slowdown that accompanied the global financial crisis ended in June 2009.

Of course, this time around it might just take a little more time than usual to rebound. The United States enjoyed 10 recession-free years from early 1991 through early 2001. That's the longest uninterrupted period of prosperity in 150 years of record-keeping. That means unless this is another historically unprecedented moment, another recession will arrive by June 2019.

True, most economists don't see an imminent slowdown. They expect the Fed to eventually begin to raise interest rates in response to the economy's strength and its ability to weather tighter monetary policy. As Goldman Sachs explained in a research note, the unusually slow recovery implies a longer-than-usual cycle. The bank does not forecast a recession for 2016, the last full year that Barack Obama will occupy the White House.

If correct, that makes any slowdown a problem for, take your pick: President Donald Trump, Carly Fiorina, Bernie Sanders, Hillary Clinton, etc. If it starts early enough in the 45th president's first term, the commander in chief might be able to place the blame at Obama's doorstep. But every time since World War Two that an American president faced a recession that began after his first year, he failed to win re-election.

Presidents don't deserve all the blame for the unavoidable cycles of developed economies. That doesn't stop voters from thinking otherwise. Moreover, if the next boss happens to be Jeb Bush, a recession on his watch would mark the fourth in a row to have begun under a member of his immediate family. He and his rivals need to brace for the inevitable.

Published September 2015

ANTICIPATION

DISNEY AWAKENS THE FINANCIAL POWER OF THE FORCE

BY JENNIFER SABA AND ANTONY CURRIE

Walt Disney is about to awaken the financial power of the Force. The media conglomerate appeared to have fallen for a hokey religion when it paid $4 billion for Star Wars maker Lucasfilm in 2012. Now, as it prepares to unleash the first of six new movies in the space saga, it may be on track to more than triple its money.

Advance ticket sales for "The Force Awakens" smashed records even before its Dec. 18 opening. That gives the movie a good shot at displacing "Avatar" as the top-grossing movie of all time. The 2009 hit pulled in $2.8 billion in global box-office revenue, according to Rentrack data.

People dressed as Storm Trooper characters from Star Wars waiting to purchase toys in advance of the film "Star Wars: The Force Awakens" in Times Square in New York, Sept. 3, 2015. REUTERS/Carlo Allegri

As with "Avatar" before it, debuting in December avoids the glut of wannabe-blockbuster movies that usually come out in early summer. So no Jedi mind trick should be required to persuade moviegoers to shun other flicks in favor of the continuing adventures of Luke Skywalker, Han Solo and Princess (now General) Leia Organa – along with new characters.

Assume the film directed by J.J. Abrams rings up a more conservative $2 billion in worldwide ticket sales – a Breakingviews estimate that takes the average box-office receipts of the top 10 movies released around Christmastime. Factor in production and marketing costs as well as theater revenue splits, and pre-tax profit would be about $700 million.

Meanwhile, revenue from licensing and the oodles of toys, action figures, books, clothing and other items that will carry the Star Wars mark could hit $500 million over the next year, according to Macquarie's Force-enhanced gaze into the future. Apply Disney's consumer-product operating margin of 40 percent, and that adds another $200 million of operating earnings. Home entertainment and video streaming may yield another $300 million.

Tally it up and Disney could squirrel away $1.2 billion before tax in the next 12 months – and that doesn't factor in any revenue from amusement parks, TV spinoffs and the like. It's unlikely to do as well on the five movies to follow – past Star Wars sequels brought in, on average, 25 percent less. On that basis, and after handing over 30 percent to the Republic of Uncle Sam, the company run by Bob Iger could earn an average of $669 million in each of the next six years.

On Disney's current stock market multiple of around 20 times 2016 earnings, Lucasfilm would be worth $13.3 billion. That may be insignificant next to the power of the Force, but it's a payoff even Jabba the Hutt would be happy with.

Published December 2015

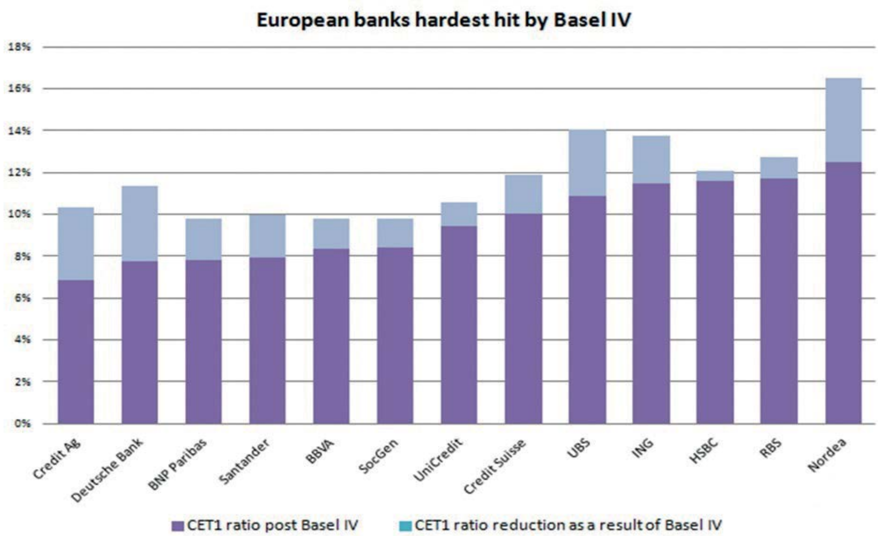
BANK RULE ZEALOTS WILL BE FORCED TO BACK DOWN

BY DOMINIC ELLIOTT

Bank capital hawks are about to bump up against the realities of politics. Basel-based standard setters are due to finalise capital adequacy reforms that banks call Basel IV over the next 12 months. The catch is that these tweaks to the pre-existing Basel III framework conflict with European policymakers' growth plans.

Basel IV is needed to harmonise assessments of credit, trading and legal risks. European banks' measurements of their risk-weighted assets – a key determinant of their capital requirements – are suspect, insofar as they sometimes produce low results and differ by jurisdiction. U.S. peers, by contrast, typically carry fuller risk-weightings on their balance sheets: they lend less to corporations and offload lower-risk mortgages to government-sponsored enterprises.

The full implementation of Basel IV may take several years. But the key question is whether European lenders, once it does kick in, will need to maintain their key common equity Tier 1 ratios at the current level of about 12 percent of RWAs.



Source: Barclays research, Reuters Breakingviews. REUTERS/Dominic Elliott

Bank of England Governor Mark Carney's answer to that question, for the UK at least, is no. Though he backs greater harmonisation in measuring asset riskiness, Carney argues that the UK regulator already forces banks to hold capital in anticipation of RWA reforms. So UK banks will only need to exceed a 9.5 percent common equity Tier 1 ratio under Basel IV and they won't need new capital.

Euro zone politicians and regulators could follow Carney's lead. European Central Bank President Mario Draghi is keen to jumpstart Europe's securitisation market, but Basel IV could raise the relevant capital requirements by 2.2 times, according to an ISDA-led lobbying group. European politicians care more about improving the euro area's anemic growth rate, which the International Monetary Fund puts at just 1.7 percent in 2016.

Brussels will want a slight uptick in lending to continue. So Basel IV will be in its sights, given Barclays analysts reckon it could knock 2.2 percentage points off lenders' common equity Tier 1 ratios. European financial services commissioner Jonathan Hill has already commissioned a review of the net effect on economic growth of various post-crisis rule changes. Its conclusion may be that Basel IV should either result in lower capital requirements, or be substantially watered down.

Published December 2015

CHEAP BATTERIES WILL GIVE UTILITIES ELECTRIC SHOCK

BY KATRINA HAMLIN

Power suppliers have long enjoyed a natural monopoly. But the arrival of budget batteries coupled with cheaper solar power will allow a growing number of consumers to pull the plug on old-fashioned electricity networks in 2016 and beyond.

Solar panel prices have already plummeted, and batteries look set to follow in the near future as manufacturers hone new technologies and ramp up production. Tesla says it can slash the cost of its own batteries by more than a third with a bigger, better factory. That's plausible: costs dropped by 14 percent on average every year between 2007 and 2014. Broker CLSA reckons they will tumble by a further 70 percent over the next five years.

The prospect of being able to generate, store and manage their own power may prompt some customers to leave the grid. In parts of developing economies where electricity has yet to arrive, power networks may not be needed. More than a fifth of India's population does not have access to electricity. Rather than waiting for infrastructure to expand, Prime Minister Narendra Modi's government is offering a 30 percent subsidy to encourage homeowners to use solar to become self-sufficient.

Energy companies' initial responses to this potentially existential crisis have ranged from denial to defensiveness. Doing nothing is not a great option, but actively resisting the shift is worse. In Australia, industry lobbyists initially tried to fight special subsidies for renewable energy and raise fees for homes with solar panels. Though such bullying tactics will burn solar homeowners in the short term, it only encourages them to seek ways to harvest and hoard their own energy.

Some power companies have decided to embrace change. Australian utilities AGL Energy and Origin Energy now sell solar panel and battery sets to their own customers. Though there's a risk the move will dim demand for conventional electricity, the bet is that clients will stay connected to the grid in order to sell their extra volts back to the utilities. In that case, the grid will survive as an exchange where energy is traded between large and small producers and consumers.

Others would be wise to heed their example and take action. Battery power is about to deliver an electric shock to the old system. Utilities will have to see the sunny side if they are to survive.

Published December 2015

VIRTUAL REALITY WILL SPRING TO LIFE IN 2016

BY QUENTIN WEBB

Newly launched headsets from Facebook, HTC, Sony and others will help turn the immersive artificial environments of virtual reality into what could soon become a $10-billion-a-year commercial reality.

For decades the dream of VR has remained unfulfilled. Nintendo's 1995 "Virtual Boy" console, for example, was an infamous flop, complete with red-and-black wireframe graphics. Later equipment often made users nauseated, as eyes and body received conflicting information.

But advances in processing power now make for far smoother, more compelling experiences in VR and augmented reality, its less intense cousin. Tech giants and venture capitalists reckon the duo may become the next big computing platform after mobile. Investors have poured some $4 billion into AR and VR firms since 2010, PitchBook says.

This should start bearing fruit in the first half of 2016, as HTC's Vive, Facebook's Oculus Rift, and Sony's PS VR headsets go on sale. Samsung's

A visitor plays a game on a PlayStation VR at the Paris Games Week, a trade fair for video games in Paris, France, Oct. 28, 2015. REUTERS/Benoit Tessier low-end Gear VR is already out, while Microsoft is working on the HoloLens visor. Developers like Japan's Bandai Namco, Capcom and Square Enix are preparing games in genres from horror to romance.

As usual, early adopters will be gamers and gadget enthusiasts. Wider adoption will require vaulting a couple of hurdles: that no one looks good wearing a clunky VR headset poses a marketing challenge; and the hardware needs apps with broader appeal. But that should come. There are many potential uses: students could attend distant lectures; fans could sit front row at sold-out concerts; architects could walk the halls of unbuilt buildings; and so on.

The initial financial impact will be modest, but this could ramp up quickly. Nomura analysts estimate sales of home-based VR kits will be sub-$2 billion in 2016, largely in hardware. By 2020 that could be $10.4 billion, with 45 percent in software.

Major beneficiaries will include programming houses and hardware specialists like Nvidia, the graphics chipmaker. Among the bigger players, success in VR would be a big boost for HTC, whose handset business is ailing, and help cement Sony's dominance in console gaming. It would also vindicate Facebook boss Mark Zuckerberg's bold, $2 billion bet on Oculus. The tech industry could be about to change reality again.

Published December 2015

RAIL MEGA-DEAL HOLDS TICKET TO RUNAWAY M&A TRAIN

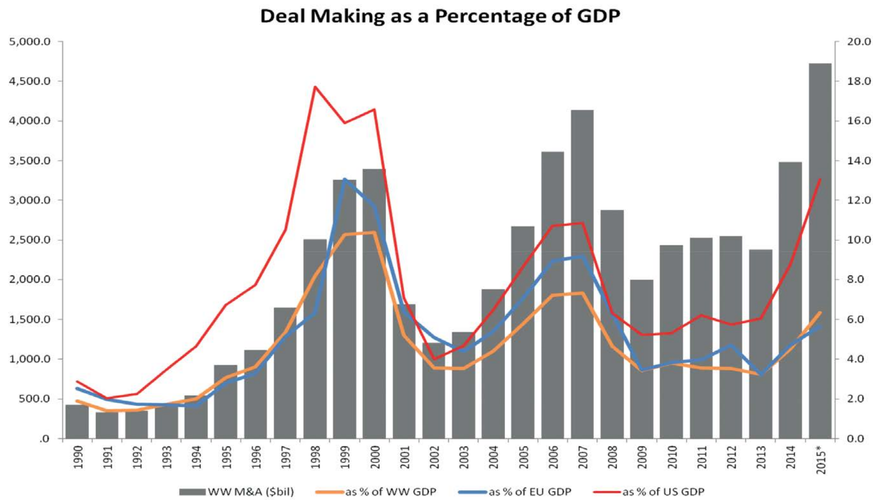
BY JEFFREY GOLDFARB

The runaway mergers and acquisitions train is barreling into its third year. Global merger volume in 2015 shattered the $4.1 trillion annual record set in 2007. As measured against worldwide GDP, the rate nearly doubled to more than 6 percent in just two years. To understand why this level of activity could stay on track for a while longer, look at North America's railroad mega-deal.

Canadian Pacific in mid-November disclosed a $28 billion offer to buy U.S. peer Norfolk Southern. The Calgary-based railway operator is grappling with low growth. Its revenue is projected to increase by just 2.4 percent in 2015 compared with almost 8 percent for each of the last two years. It's not alone: S&P 500 Index constituents suffered a collective third-quarter sales drop of 3.9 percent, according to FactSet. That stark reality will be a motivating force for mergers.

The shareholder roster at Canadian Pacific offers more insight. Its biggest investor was hedge fund billionaire Bill Ackman's Pershing Square. He originally unveiled a stake in late 2011 when the company's stock was trading at about $60. It more than tripled in three years before sinking back to around $130. Activist investors like Ackman have doubled their funds to some $130 billion in two years and piled into nearly every industry. Their pushiness will drive plenty more deals like Canadian Pacific's.

Further consider the nature of the rail bid. It involves a Canadian company stalking an American one. Cross-border transactions tend to pick up as merger momentum gathers steam. About 44 percent of deal volume in 2007 included a buyer and seller from different countries, according to Thomson Reuters data. In 2015, it was about a third, suggesting there may be capacity for more.



Source: Thomson Reuters, IMF GDP figures. REUTERS/Jeffrey Goldfarb, Rob Cox

Similarly, Canadian Pacific's offer was unsolicited. Such aggressive approaches, including ones eventually withdrawn, accounted for 15 percent of M&A in 2007 compared with about 14 percent in 2015. Lofty valuations could make targets more demanding and eager suitors increasingly frustrated.

Finally, the rail tie-up is messy. That tends to be a hallmark of deals near the end of an M&A boom. Merger partners become harder to find, testing competition limits or leading to mission drift. Norfolk Southern rejected its rival's overtures on Dec. 4 in part because it suspected the combination wouldn't be approved by regulators. Don't expect that to stop many other buyers just like Canadian Pacific from trying.

Published December 2015

A (FAKE) BANK CEO MEMO ON PLANS TO LEAVE LONDON

BY ROB COX

The following is a fictional memo from the office of the chief executive of a big American bank to employees sent on the occasion of the British referendum on European Union membership:

Dear colleagues,

You are by now aware of the British electorate's vote last night to leave the European Union. While we had hoped for a different outcome given our considerable investments in the United Kingdom, we have been preparing for this possibility for the past two years. Fortunately, we are in a position to act quickly.

Thanks to the work done by our "Brexit Task Force," which we formed in late 2015, we have architected a cross-platform contingency plan that will see many of the functions now performed by the London-based broker-dealer migrate to regional EU centers. While this transition will not be simple, and there will be some employee dislocation, we expect clients will not notice a significant difference.

In the past 12 months, the company has invested $50 million in scenario planning related to the referendum. As part of that process, we have effectively routed nearly 85 percent of the bank's retail and commercial lending activities through our Dublin-based banking subsidiary.

Our facilities management team has procured options on additional office space in preparation. Front-office customers will be served from our Client Performance Hubs in Frankfurt and Madrid. Support and administrative functionality will gravitate towards our Center of Compliance Excellence in Gdynia.

Overall, we expect to migrate less than 20 percent of our current operational workforce in the UK, numbering about 5,600 people in total, over the coming two years.

Many of you have asked why we did not campaign harder for Britain to stay in the EU given the investments we have made in the City of London over the past few decades. The short answer is that we felt the optics of a large Wall Street bank visibly trying to sway opinion would backfire. The financial services industry is still rebuilding public trust after the 2008 crisis.

We had hoped that Prime Minister David Cameron's efforts to renegotiate the terms of Britain's membership in the EU would bear fruit. Unfortunately, the numerous attacks perpetrated in many European cities in recent months by supporters of the so-called Islamic State have weakened the domestic political positions of German Chancellor Angela Merkel and other counterparties critical to the reform process.

I appreciate your patience as we work towards a new, dynamic operating structure for the bank in Europe. The Brexit Task Force will be toiling diligently to identify which positions in London may be transferred to the continent on a going-forward basis, and to plan for the effect of lifting the financial transactions tax, and the cap on banking bonuses for UK-based employees.

In the meantime, I urge you to continue your dedication to serving our customers and to upholding the value principles of the bank. Britain's participation in the EU may draw to a close, but business continues as normal.

Sincerely,
Bank CEO

Published December 2015

CHINA WILL STOP IGNORING FACEBOOK'S FRIEND REQUEST

BY ROBYN MAK

China will "friend" Facebook again in 2016. Chinese censors blocked access to the $300 billion social network barely a year after it launched there in June 2008. Yet founder Mark Zuckerberg is going to great lengths to leap the Great Firewall. Rivals have shown that foreign groups can play by local rules.

A 3D plastic representation of the Facebook logo is seen in front of displayed cables in this illustration in Zenica, Bosnia and Herzegovina May 13, 2015. REUTERS/Dado Ruvic

Even though China's 668 million web users can't access Facebook, the Silicon Valley company says the People's Republic is one of its largest advertising markets as Chinese businesses eyeing overseas markets target Facebook's 1 billion daily active users. That's significant as ads brought in more than 95 percent of the company's $4.5 billion in revenue in the three months to September.

Now Zuckerberg is eager to connect his social network to the world's largest internet population. The 31-year old CEO hosted a meeting with China's internet policy chief in 2014 and met with visiting President Xi Jinping in October. The hoodie-clad founder is also learning to speak Mandarin.

None of this will necessarily sway Chinese bureaucrats. Yet there are signs that relations with U.S. tech groups are thawing, provided the latter bend to local rules. Jobs networking site LinkedIn, for instance, censors certain content on its Chinese site, while note-taking app Evernote has disabled a note-sharing feature on its Chinese service. Both store local data in China as well. These strategies are paying off: LinkedIn already had around 4 million mainland users when it formally launched its Chinese service in February 2014. Now it has 10 million.

What might a Chinese Facebook look like? Posts deemed too sensitive from accounts in China would be blocked in the country, while censors could also filter content from abroad. If this proved too complicated, Facebook could even opt to launch a separate service, such as an event planning app, to test the waters.

Finding a local partner would help to seal the deal. Google, which retreated from the People's Republic five years ago over censorship concerns, will introduce a Chinese app store in 2016, Reuters reported on Nov. 20. A partnership with local smartphone maker Huawei, which makes Google's handsets, should give it a boost. Facebook could persuade another domestic manufacturer like Xiaomi to pre-install its app on Chinese phones.

Re-entry would only be the beginning as Facebook would face a fierce fight with local networks like Tencent's ubiquitous WeChat. Zuckerberg will need all the Chinese friends he can get.

Published December 2015

CAPITAL SQUEEZE WILL SPARK UNICORN M&A ORGY

BY ROBERT CYRAN

A capital squeeze may stimulate an orgy among unicorns. Plentiful money has detached valuations on many hot private tech firms from reality. There are 144 of these private companies worth $1 billion or more, according to CB Insights. Curiously, about a third are valued at $1 billion on the dot. As capital becomes more expensive in 2016, selling to rivals or mating with other unicorns will become appealing.

Few of these young companies are cash-flow positive, so most will need capital infusions to survive. That spigot is slowly dwindling. Fidelity Investments recently marked down the value of its Snapchat and Zenefits holdings, and BlackRock slashed the value of its Dropbox stake. If massive asset managers pull back, private firms will be dependent on tinier venture capital outfits, which may be more demanding in their terms.

Even hardened angel investors are becoming skeptical. Marc Benioff, Salesforce.com's founder, says he will no longer invest in unicorns because they have "manipulated private markets to obtain these values."

Going public is an option. American technology firms' proceeds from initial stock sales so far this year are $6.1 billion – a fifth the amount they raised last year, according to Thomson Reuters data. Global trends are similar. Claims that remaining private allow founders to retain a long-term focus look suspect. Super-powered voting stock allows insiders to treat public companies as their fiefdoms. But the stretched private valuations make it harder for unicorns to go public. Insiders do not want the ignominy of a so-called down round. Floating at a reduced price also creates the impression something has gone wrong. That can make it difficult to lure customers and talented engineers.

M&A may be a better option. Two of China's private taxi apps, Didi and Kuaidi, combined in February to gain scale against Uber, and the combined valuation ballooned. Didi Kuaidi recently invested $100 million in U.S. based Lyft. Lyft could seek shelter from Uber by selling itself to Didi Kuaidi or partner Hertz.

Other unicorns that have run into trouble could also find comfort in the arms of bigger, more mature rivals. Benefits manager Zenefits might make a nice target for Workday or ADP. It's easy to see how cloud-storage firm Dropbox might drop nicely into the portfolio of Microsoft.

Insiders may not wish to sell at public market valuations. Tacking on a change of control premium would help narrow this gap. And a lack of cash flow and scarcer private capital may eventually force their hands.

Published December 2015

LONDON'S BANKERS SHOULD RETRAIN AS BUILDERS

BY GEORGE HAY

Here are two predictions about the UK labour market for 2016. Banks with swollen cost bases and anemic growth will lay off tens of thousands of people. And chronic skills shortage will stop the country from building the houses it needs to offset rising prices. In an ideal world, that means that bankers ought to think about becoming builders.

Banks have a problem that isn't going away. Expenses are too high for returns to exceed costs of equity, especially because once-proud fixed income divisions now have to hold lashings of capital. Almost every bank has launched multi-year cost-reduction programs: HSBC is cutting up to 25,000 jobs by 2017, Standard Chartered plans 15,000 by 2018, while Barclays said in 2014 it would aim for 19,000 by end-2016. In sum, these three plus Lloyds Banking Group and Deutsche Bank will lay off 77,000 staff, with over a third likely to be in the UK.

British homebuilding has the opposite problem. The sector has lost 300,000 workers since 2008 as builders retrained away from a denuded sector. At the very least, it needs to build 80,000 houses a year above the 141,000 it managed in 2014 to keep pace with household formation, according to consultant Arcadis. With the average home having required 1.5 workers annually to get built, that implies Britain needs to find at least 120,000 new house builders.

It's sadly unlikely that sharp-suited corporate financiers will suddenly opt for a life of hod-carrying. But the culture clash between life on a construction site and that of a fixed-income trading floor, where the deepest cuts are occurring, may not be so great. This may even apply to pay: the deficit of bricklayers is sufficiently extreme for skilled tradesmen to be able to demand annual incomes of over 60,000 pounds. By way of comparison, the average compensation for Barclays' 132,300 employees in 2014 was just over 67,000 pounds, although those facing the chop may be towards the higher end of the scale.

Were the UK government minded to bring house prices back under control, it would probably have to publicly fund most of the extra houses needed. That could provide the delicious irony of masters of the universe becoming salaried employees of the state. But if any financial types fancy a pivot into something undeniably socially useful, they should head sitewards.

Published December 2015

DROUGHT, NOT JUST OF IDEAS, CHALLENGES AFRICA

BY ROB COX

On Oct. 18, Zambian President Edgar Lungu called off soccer games and closed bars and restaurants for a day of national prayer. "I personally believe that since we humbled ourselves and cried out to God, the Lord has heard our cry," Lungu told the 15 million people of the landlocked African nation. Sadly for Zambians, God heard things differently.

Lungu implored his people to pray for the national currency, the kwacha. Having dropped by nearly half since he took over in January – almost perfectly tracking the sliding price of his country's chief export, copper – Zambia needed some divine intervention. Since imploring his people to genuflect, the kwacha has fallen another 14 percent.

Zambia is a cautionary reminder of how quickly the prospects for growth and prosperity can shift, especially in Sub-Saharan Africa. A year ago, Zambia was expected to lead its neighbors in boosting economic output. In

June of last year, the World Bank forecast Zambia's gross domestic product would be nearly 7 percent greater by the end of 2015. The country even warranted a shout-out in our Breakingviews 2015 Predictions book.

As it stands, the country will be lucky to expand by more than 5 percent by the end of the year. While that's certainly better than, say, Italy, it needs to grow far faster to pull Zambians out of poverty. Gross domestic product per capita in Zambia is below $2,000, or just an eighteenth of Italy's. It's a similar story from Accra to Zululand.

While the World Bank calculates that Sub-Saharan Africa's GDP growth has been faster than the developing world's average, excluding China, since the 2008 financial crisis, progress is threatened on too many fronts. Just a few of them are of domestic manufacture. While bad economic thinking and corruption are still rampant in much of Africa, Mother Nature, alongside myriad problems in the rest of the world, is set to take an unusually high toll.

Zambia and its neighbors Botswana and South Africa account for about a quarter of Sub-Saharan Africa's GDP. The oil spigot that is Nigeria comes in for about a third. The nations on the southern tip carry considerable weight in determining the region's growth picture. So a potentially devastating water shortage there comes at a terrible moment.

Water is needed to grow food for people and animals. It's also critical to the mining industry – not simply as a raw material used in the process of extraction, but to generate energy. Zambia gets nearly all of its electricity from three major dams, including one at the usually glorious, now dry, Victoria Falls. As a result, copper production has slowed just as the metal's price has dropped. Many mining operations are only managing to stay open by using generators powered by expensive, imported diesel fuel.

All of this comes as the mining and energy business globally is reeling from the crash of the commodities super-cycle. Mines are closing and jobs are being cut across the industry. South African platinum producer Lonmin, which traces its roots back to British imperialist Cecil Rhodes, just detailed a bankruptcy-avoidance plan that sees it shedding some 6,000 jobs.

Meantime, the effect of sparse rainfall is leading to rising food prices. The National Agricultural Marketing Council of South Africa reported a 4.1 percent increase in basic food prices in the year to July. "This could have a negative impact on household food security in South Africa, affecting the affordability of selected staple foods (bread) as well as various food items making a contribution to dietary diversity," the council warned.

This sort of inflation is particularly worrying in poor nations where the percentage of wages dedicated to sustenance can be higher than 40 percent of household income. The rising cost of putting food on the table threatens to further erode social stability in South Africa. Recent protests, some of which have turned violent, over university tuition would pale in comparison to riots by the poor in the cities and the townships fueled by empty stomachs.

As if Planet Earth weren't dealing parts of Africa a bad enough hand, the Federal Reserve's prospective tightening of interest rates is sucking capital away from riskier nations, and an actual increase is likely to continue the trend. The financial pressure has manifested itself starkly in currencies like the South African rand, which is down 22 percent in 2015, along with Zambia's kwacha. Cheaper currencies add to the cost of importing food.

A woman fetches drinking water from a well along a dry Chemumvuri river near Gokwe, Zimbabwe, May 20, 2015. REUTERS/Philimon Bulawayo

Some African own-goals make matters worse. As foreign direct investment is already drying up, Nigeria recently meted out a whopping $5.2 billion fine on the South African mobile phone operator MTN for failing to deactivate 5.2 million unregistered phones. By almost any measure, the punishment was disproportionate to the crime, and is double what MTN is expected to earn this year. Moves like this, and South African President Jacob Zuma's lackluster economic stewardship, make it harder to attract foreign capital to the region.

Rising food and energy costs may be a function of climate, or God. Sliding commodity prices and currencies owe more to the slowdown in China and the monetary policy of foreign central banks. Throw them together with Africa's perennial corruption and mismanagement, and it's hard to see a particularly bright spot on the continent in the coming year.

Published November 2015

A HARD RAIN'S A-GONNA FALL

BALANCE SHEETS WILL GET MORE UNBALANCED IN 2016

BY JOHN FOLEY

The lesson that too much debt is dangerous has sunk in. But for many companies, the corollary proposition, that too little cash is a killer, seemingly hasn't. If there's one thing investors ought to remember heading into the eighth year since the financial crisis, it's that without healthy cash flows, balance sheets won't stay balanced for long.

Trading house Glencore is a prime example. As commodity prices continued to plunge in 2015, its net debt of $27 billion, which investors had previously tolerated, started to look scary. The shares went into freefall. As cash flows dwindled, so did the amount of debt investors would stomach, forcing boss Ivan Glasenberg to hack the dividend, sell assets, cut production and reduce borrowings to $18 billion.

Weak commodities will wreak more havoc, but rising U.S. interest rates could make matters worse. That's especially true for emerging markets, which have loaded up on U.S. dollar debt. A currency mismatch is one factor weighing on Brazilian oil major Petrobras. Non-bank borrowings in U.S. dollars had reached $2.3 trillion in developing countries by the end of June, according to the Bank for International Settlements. Mexican, Indonesian and South African borrowers have all doubled their dollar debts since 2009.

Europe has its own toxic cocktail, of stubbornly low inflation and poor consumer demand. Yet some companies are still casual about cash. One in four companies in the Euro Stoxx 600 index outside of banking and energy spent more on operations, capital expenditure and dividends than they made in the past 12 months, according to Eikon data. British grocers Tesco and J Sainsbury, telecoms group Vodafone and carmaker Daimler have all spent beyond their means for three consecutive years, as have numerous oil and energy groups. For some, dividends and investment will be vulnerable.

Who, if anyone, has learned their lessons? That would be the United States. Outside of resources and finance, the ratio of U.S. corporate net debt to EBITDA is now only slightly above the 20-year average of 1.6 times, according to Credit Suisse. Brazil, by contrast is 4.5 times. Only about 17 percent of these U.S. companies are spending more cash than they make. For once, America has something to teach the world about leverage.

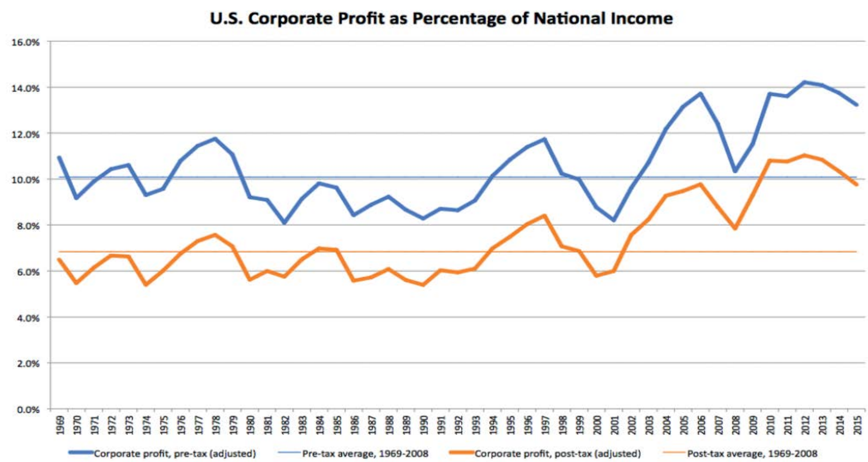
When the reckoning comes, cash-rich companies and private equity firms will be in a position to sweep in and acquire assets on the cheap. More likely than not, they'll come with American accents.

Published December 2015

GLOBAL CORPORATE PROFIT IS UNDER SERIOUS THREAT

BY RICHARD BEALES

Quarterly capitalists should gird themselves for disappointment. With post-tax earnings running around 10 percent of national income, according to the Bureau of Economic Analysis, U.S. companies are close to a peak of profitability not seen since at least the late 1960s. High levels of corporate



Source: Bureau of Economic Analysis, Breakingviews calculations. REUTERS/Richard Beales profit are a global phenomenon, too. Competition, disruption and tax policy – not to mention weaker growth – are set to change all that.

Worldwide, net income after interest and taxes increased fivefold between 1980 and 2013, according to a study published in September by the McKinsey Global Institute, not far short of doubling as a share of global GDP to 7.6 percent.

The consultancy's think tank foresees competitive pressure on margins from emerging markets like China. Fast-growing companies are starting to go global, and their tendency to be controlled by government or family interests may mean they can accept lower profitability in the short term than Western multinationals whose investors watch quarterly earnings closely.

Meanwhile, though the profit pie has grown, gains have gone disproportionately to technology and other idea-driven sectors at the expense of traditional industry. That trend could continue, with even today's biggest tech firms – the likes of Apple and Alphabet (formerly Google) – themselves potentially vulnerable to upstarts wielding new ideas. The MGI also notes that the scope to cut costs, for example the outsourcing of production to China by Apple and others, could be bottoming out. Borrowing costs, which have lingered at historic lows thanks to the world's central bankers, also look set to rise.

Slackening economic expansion is another factor. One consequence, the collapse in oil prices, is largely responsible for a plunge in the U.S. energy sector's profit. As a result, analysts predict that overall S&P 500 Index earnings for 2015 will be a hair lower than in 2014, according to S&P Capital IQ's tally on Dec. 16. They remain relatively optimistic, though, forecasting 8 percent growth in S&P 500 profit for 2016.

That sounds bullish. Companies face other headwinds, including tax policy. The recent furor over tax-reducing mergers by U.S. companies – notably drugmaker Pfizer's $160 billion deal with Allergan – is just one instance of authorities questioning whether businesses pay enough to governments. Investors who have gotten used to earnings ratcheting higher every quarter may want to reset their expectations.

Published December 2015

VOLKSWAGEN TOP BRASS WILL BE UP FOR THE CHOP

BY OLAF STORBECK

Volkswagen's chairman and chief executive are both new to their roles. But in the coming months the German carmaker faces both multibillion-euro fines as a result of cheating on its diesel emissions as well as a scathing external report on its governance. These will shine a spotlight on leaving long-term insiders in charge.

Matthias Mueller, who took over as CEO after the emissions scandal cost Martin Winterkorn his seat at the wheel, is a VW lifer and former Porsche boss. Hans Dieter Poetsch, meanwhile, spent 12 years as finance chief before becoming chairman.

There's some justification for appointing one of them: steering the overly complex vehicle that is Volkswagen through an existential crisis arguably requires detailed knowledge of its inner workings. Installing both of them, though, seems tin eared. Of the two, Poetsch looks the more exposed.

Ferdinand Piech is pictured during a welcoming ceremony at the plant of German carmaker Volkswagen in Wolfsburg April 23, 2012. REUTERS/Fabian Bimmer

First, he's a confidant of Ferdinand Piech, the towering patriarch of the Porsche family, VW's controlling shareholder. Piech spent 22 years as boss and then as chairman of Volkswagen until being forced out in a power struggle in April 2015. He started the empire building and created the internal fiefdoms and sclerotic culture that worsened under Winterkorn.

Poetsch is also, thanks to having held a seat on the executive board as finance director, one of those who can be held legally responsible for any company misconduct in the emissions scandal. And he is central to a key legal issue: whether the 17-day delay in September in informing investors about its emission woes after admitting cheating to U.S regulators can be justified.

All this puts Poetsch in a difficult position to start with for many of the tasks he will have to carry out as chairman. These include assuaging the anger of American regulators, lawmakers and VW shareholders.

His role is likely to get even trickier as scandal-related costs mount: the 8.7 billion euros the company has so far set aside do not cover any fines; and the U.S. Environmental Protection Agency alone could impose a penalty of up to $18 billion. Meanwhile, U.S. law firm Jones Day's investigation into the inner workings of the scandal will probably unmask the carmaker's rotten internal culture as well as whatever role Poetsch played. Appointing an independent chairman in 2015 would have been a smart move. In 2016, it will become a necessity.

Published December 2015

LUXURY GROUPS COULD SHRINK THEIR WAY TO RICHES

BY CAROL RYAN

Less is more. But apparently luxury companies don't feel that applies to their swollen store networks. Labels like Prada and LVMH have spent a decade expanding rapidly to meet emerging market demand. Slowing sales and overexposure suggest it's time to go the other way. While cutting back will be painful, it could spur higher luxury valuations.

The global market for luxury has ballooned in 10 years, mainly because of China's rise. Storefronts have blossomed accordingly. Consider the tripling of Burberry's retail locations over that time. Prada has more than doubled in size since 2009 – with 629 locations by 2014. Hermes is one of the few that has been conservative. It opened 65 shops since 2005 – or 26 percent growth over a decade.

That has helped create new sales – but the numbers aren't that impressive. Revenue growth at Burberry has been 226 percent, suggesting average annual growth of 14 percent, where store numbers have grown an average 13 percent. Prada's sales have also kept pace with new openings, suggesting both relied heavily on additional shops to beef up their top line.

Hermes snubbed the easy money and focused on organic growth. It's the harder route but has made its store network far more efficient. A quarter increase in its retail footprint led to a near-tripling of sales from 1.4 billion euros in 2005 to 4.1 billion euros in 2014.

Now that luxury sales are slowing, and falling in China, the maths work against the likes of Burberry and Prada. With their store networks at saturation, their old growth story is over. Hermes, though, is still forecasting 8 percent annual growth, even when the global market for personal luxury has slowed to 1 percent to 2 percent.

The pace of expansion has also overexposed many luxury brands. Burberry has 17 stores in Hong Kong alone – that's more than cheap fast-fashion Spanish label Zara. There is a glut of stores in China. Yet Chinese shoppers are now buying 70 percent of their luxury trinkets abroad, according to consultant Bain. It would be a brave move to abandon a decade-long habit of growth, but then as Coco Chanel once reputedly advised, "elegance is refusal."

Published December 2015

BRAZIL CRISIS MAY HAVE SILVER LINING: RULE OF LAW
BY MARTIN LANGFIELD

The news from Brazil will get worse before it gets better. The arrest of billionaire banker André Esteves suggests room for further nasty surprises from the Petrobras corruption probe. The roughly $2 trillion economy, Latin America's biggest, is tanking. President Dilma Rousseff could get impeached. But feisty independent courts and stronger institutions point to a brighter future.

The arrest of Esteves and Delcidio do Amaral, the ruling Workers' Party leader in the Brazilian Senate, is the latest salvo in a massive investigation into bribes and kickbacks at state oil giant Petroleo Brasileiro. It has rippled through the economy, affecting construction and power companies and even threatening to tarnish the upcoming Olympic Games in Rio de Janeiro. Fiercely independent judges are spearheading the probe, and Rousseff is in no position to try to influence them. Some 50 politicians are being investigated for bribery.

André Esteves, former CEO Brazilian BTG Pactual bank is pictured during an interview in Sao Paulo July 22, 2014. REUTERS/Nacho Doce

Rousseff herself has not been implicated, though she chaired the Petrobras board when much of the alleged improbity occurred. But she is hugely unpopular, blamed for sending the economy into its worst recession in 25 years and the austerity she espouses to fix it. Demonstrators have called for her impeachment.

Brazil's institutions have been growing stronger since democracy was restored in the 1980s, however, and can act as a bulwark against the populism Rousseff has compared to coup-mongering. If she is impeached, it would probably be for dodgy government accounting practices rather than incompetence and would only happen after a long process in Congress. She could also be in trouble if the Petrobras probe, known as Car Wash, finds illicit contributions to her 2014 re-election campaign.

Plea bargains and other legal measures have made it easier to investigate companies since a huge vote-buying scandal known as the mensalão broke a decade ago. Though the court system has pockets of corruption and bogs down in red tape, a well-functioning judiciary can offer more security for investors and eventually help the economy recover.

The nation stands out from regional laggards like Venezuela, where the Bolivarian revolution of Hugo Chavez and his hapless successor, Nicolas Maduro, has seriously compromised the independence of government institutions. Facing crises of their own, such countries would do well to watch for the silver lining in Brazil's: the rule of law.

Published November 2015

THE ILLUSION OF DEBT-FUELLED EARNINGS

BY EDWARD CHANCELLOR

Low rates have forced investors into a dangerous search for yield. Just look at the surge in junk-bond and emerging-market corporate debt sales over recent years. Cheap money has also driven record levels of stock buybacks in the United States and fuelled a boom in corporate mergers.

The company logo of Valeant Pharmaceuticals is seen at its headquarters in Laval, Quebec May 19, 2015. REUTERS/Christinne Muschi

This is evidence of what the Japanese call "zaitech" – the use of cheap capital to boost reported profitability. Like all grand experiments in financial engineering, though, this one too will come unstuck.

Japan's infatuation with zaitech arose in the late 1980s, at a time when economic growth was slowing and the rising yen threatened corporate profits. Many companies responded to those headwinds by issuing warrant bonds in the eurodollar market, swapping the proceeds back into the domestic currency and investing in Japanese shares, which were held in special trust accounts.

While the Tokyo stock market soared, these companies enjoyed rising earnings and a negative cost of debt funding. However, after interest rates rose and stocks plummeted in the early 1990s, it was game over. Many enthusiastic zaitech players, such as Hanwa, reported large losses.

The mid-1960s witnessed an earlier experiment with financial engineering in America. This was the era of the conglomerate boom. Companies such as ITT, Gulf + Western, Saul Steinberg's Leasco and Ling-Temco-Vought (LTV) expanded rapidly through acquisitions. Between 1966 and 1968, conglomerates accounted for more than 80 percent of U.S. takeovers. These conglomerates often adopted dubious accounting techniques to boost profits.

Take LTV, cobbled together by the ambitious Oklahoman James Ling. The company expanded from a core electronics business into meat packing, sporting goods, airlines, insurance and eventually steel manufacturing. Ling understood that investors – in particular, the "gunslinger" fund managers of the "go-go" era – were focused on earnings per share.

To deliver EPS growth, Ling issued convertible bonds and bank debt to finance his acquisitions. He also enticed shareholders to exchange stock for convertible securities, which further boosted EPS. Ling would often float shares in acquired companies (like today's tracking stocks) and use the proceeds to retire debt.

As long as the stock market continued rising, these feats of financial engineering worked wonders for LTV's shares, which climbed 17-fold between 1964 and 1967. After interest rates rose towards the end of the decade and the stock market turned down, the conglomerate bubble burst. LTV was forced to divest companies to pay down debt, Ling was fired, and his company ended up as a second-tier steel concern, eventually going bankrupt in the mid 1980s.

In a presentation at the Grant's Conference in New York in October, Chicago-based hedge-fund manager James Litinsky drew an intriguing parallel between the 1960s conglomerates and today's so-called platform companies, businesses which have grown rapidly through M&A.

Unlike the conglomerates, they are not diversified but focused on a single industry. Like the conglomerates, however, they have thrived in an era of financial repression, when interest rates have been kept below the rate of inflation. Like their predecessors, platform companies have been using debt to generate EPS growth. Similarly, they have been egged on by investors, with activist hedge funds replacing the gunslinger generation.

Litinsky highlighted companies from various sectors, including brewing (Anheuser-Busch InBev) and consumer staples (Kraft Heinz). But pharmaceutical companies dominate. One of them, Valeant, resembles a modern-day LTV. The firm has grown rapidly through acquisitions, such as of Bausch & Lomb, and slashing costs to meet cost-cutting targets.

Valeant promised to take $900 million from Bausch's $1.2 billion of operating expenses. Valeant's takeovers have been funded by cheap debt – interest expenses relative to long-term debt have averaged below 6 percent in recent years. Cost-cutting, takeovers and low-cost loans have boosted Valeant's EPS, which climbed from 29 cents (on a diluted GAAP basis) in the fourth quarter of 2012 to $1.56 in 2015's third quarter.

Like LTV, Valeant has adopted complex financial structures. Its ownership stake in specialist pharmacy Philidor, which distributed some of its drugs, was held through what's called a variable interest entity. Critics claim this structure, which Valeant is now unraveling, kept contingent liabilities off the balance sheet. What's clear is that Valeant has borrowed a lot – long term debt has grown from around $10 billion in late 2012 to over $30 billion today.

Corporate rollups, from LTV to Tyco International, have tended to come unstuck when they stop growing. Valeant's stock is down more than 70 percent since its peak earlier this year. Its high-yield bonds are now trading below par. Valeant's days of acquisitive growth would appear to be over.

The Valeant story is not an isolated case of aggressive financial engineering. At a time of ultra-low debt costs, announced global M&A activity in 2015 has reached a record $3.9 trillion, according to Thomson Reuters. Global non-financial investment-grade debt issuance has climbed to $1.3 trillion so far this year. Acquisition-related debt reached a record $365 billion, says Thomson Reuters.

Even more debt has been issued by U.S. corporations for share buybacks. Over the past five years, the top 100 share repurchasers have grown their EPS by 93 percent. Their return on equity has climbed to 19 percent from 13 percent during this period, according to Thomson Reuters Worldscope, and their shares have handily outperformed the broader market.

This may look impressive. But the buyback leaders have also seen their sales growth slip and leverage rise. Their median capital spending (relative to cash flow) is below the S&P 500 average. To deliver EPS growth, these companies have been leveraging up and eating their seed corn.

Valeant's fall from grace is just another example of how debt-fuelled growth creates only an illusion of value. Real worth comes from companies investing wisely for the future and acquiring shares – whether their own or in other companies – at low valuations. While corporate revenue is declining and debt is cheap, financial engineering is an easy way out – until it all falls apart.

Published November 2015

FUND GLUT WILL SEND ASIA'S BUYOUT BARONS OFF-PISTE

BY QUENTIN WEBB

A glut of funds will send Asia's buyout barons off-piste. Asia-focused private equity managers are flush with a record $162 billion of unspent capital, Preqin data shows. In the coming year firms will be tempted to overpay for assets, buy businesses that rivals have already spruced up and drift into unfamiliar kinds of deal-making.

In some ways, having plenty of "dry powder" is a nice predicament. Keen institutional interest in the higher returns promised by private equity means that buyout firms around the world have more money than they can easily spend.

But the issue is particularly acute in Asia, where the industry is relatively immature: 2014 was the first year that Asian-focused firms returned more cash to investors than they sucked up in fresh commitments, according to Bain. The region also has fewer big takeover targets, since most Asian companies are controlled by rich families or governments.

True, the picture looks slightly better close up. Strip out venture, infrastructure and property funds, and dry powder available for pure buyouts actually shrunk by $3.8 billion, to $36.9 billion, in the year to November 2015. But that is not enough to ease the overcapacity, especially as corporate buyers, sovereign wealth funds and pension giants are also jockeying for assets.

Three things are likely to happen in 2016. First, private equity firms may end up paying top dollar to win those assets that do come to market. That will squeeze returns, and raises the risk of financial distress.

Second, expect more "secondary" trades of businesses between rival PE firms. Sometimes these pass-the-parcel deals can be a good idea: for example, a new owner may be better able to help a company expand globally. But often they just look like fee-heavy asset-shuffling.

Third, watch out for style drift. Firms may venture further from the countries and sectors they know best in search of deals. Or they might compromise in other ways – taking minority stakes alongside powerful founders where it would be better to wield majority control, for example. Though doing nothing is hard, buyout specialists would do better on well-signposted routes rather than straying onto unfamiliar terrain.

Published December 2015

CLIMATE WILL SUPPLANT SHALE AS TOP ENERGY DISRUPTOR

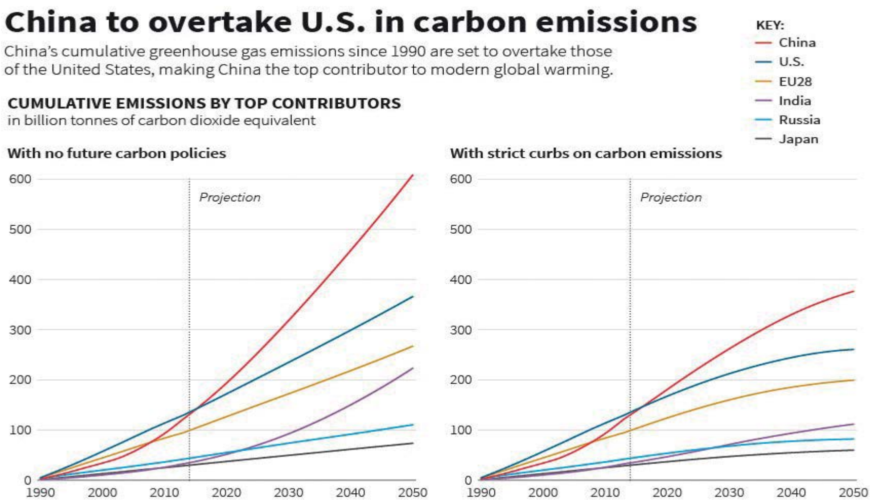
BY KEVIN ALLISON

Move over, shale: climate change will supplant the U.S. oil revolution as the energy industry's No. 1 disruptor in 2016. The world's politicians have gotten serious about cutting greenhouse gases at the United Nations climate summit in Paris. The consequences for the industry will be longer lasting than the recent revolution in oil production.

The growth of shale, largely thanks to hydraulic fracturing technology, shook up the sector over the past few years. It allowed the United States to flirt with becoming energy self-sufficient and thus reduce the political sway of OPEC. Increasing supplies also led to a drop in prices that accelerated last year as China's economic growth began to slow.

The price of crude is now mired around $45 a barrel, 60 percent off its 2014 high. That hit shares: the S&P Global Oil Index, which tracks the stock prices of 120 petroleum producers, had fallen 30 percent between mid-2014 and September 2015. It has since rallied nearly 12 percent as hopes grow that the oil price will stabilize as both shale and OPEC producers finally adjust production properly to reflect recent turmoil.

The Paris talks could upend this relief. Skeptics may find it easy to dismiss the event. Little has ever been established at these jaw-jaws in the past. The Paris U.N. summit, though – officially known as the 21st session of the Conference of the Parties – already has a good deal of momentum. The idea is to reach an accord that will reduce emissions by a large enough amount that the temperature of the earth's atmosphere will not be more than 2 degrees Celsius higher by 2100 than before the Industrial Revolution.



Source: Thomson Reuters Datastream and Center for International Climate and Environmental Research. REUTERS/C. Inton

The United States and China, which between them account for some two-fifths of all CO2 emissions, in September detailed a series of accords to start limiting these pollutants over the next 10 to 15 years. In all, nearly 180 countries responsible for some 90 percent of global greenhouse gas emissions announced reduction targets ahead of the summit.

If all their various proposals are fully implemented, it may still not be enough to meet the 2 degree goal. That's the threshold that many scientists regard as the starting point for dangerous climate change – though a growing number are putting the tipping point at 1.5 degrees Celsius. At that stage, yields from crops as currently grown may fall by roughly 15 percent, water flow in some river basins may drop as much as 10 percent while elsewhere rain falling during heaviest precipitation may jump by the same amount, causing floods.

Hitting a weaker target would still represent progress, though, especially if countries agreed to revisit it periodically with an eye to introducing more ambitious policies later.

Either way, the talks increase the focus on how exposed the energy industry is to changing environmental policy. The main concern among investors is how many so-called stranded assets companies may end up with – in other words, how much of their oil, gas and other energy reserves would no longer be viable – and what impact these will have on performance.

In 2011, researchers at the Carbon Tracker think tank calculated that companies and governments around the world own five times as much coal, oil and gas than can be safely burned without an unacceptable risk of exceeding the 2 degree limit. In a recent report, the group calculates that fuel companies risk squandering over $2 trillion of capital expenditure over the next decade – around a quarter of oil majors' potential investment – pursuing projects that may ultimately end up uneconomic due to tighter carbon policy and advances in renewable technologies. Exxon Mobil and Royal Dutch Shell would be most at risk in dollar terms.

Both companies largely dismiss talk of a carbon bubble. They argue that fossil fuels, especially oil and gas, will still be needed if policymakers want to supply a growing, more affluent global population with reliable energy. The industry appears willing to bet that the high cost of keeping global

A worker prepares to fill a car at a gas station close to Copacabana beach in Rio de Janeiro, Jan. 12, 2015. REUTERS/Ricardo Moraes

temperatures below 2 degrees Celsius will make the target untenable. Better, in that case, to keep pumping, invest in technologies to make fossil fuels burn cleaner and invest to offset the worst effects of climate change.

For the first time, though, the industry is facing a combination of both political and financial pressure. So they are unlikely to be let off the hook.

Bank of England Governor Mark Carney, for example, revealed in September that as chair of the Financial Stability Board he is considering recommending to the G20 that "more be done to develop consistent, comparable, reliable and clear disclosure around the carbon intensity of different assets." Such information could make "climate policy a bit more like monetary policy."

The International Energy Agency and several Wall Street firms have published studies supporting the carbon bubble logic. Earlier in November, New York Attorney General Eric Schneiderman issued a subpoena demanding documents related to Exxon Mobil's communication about climate risks.

Shareholders are taking a more active role, too. At times, that's simply a case of publicly committing to sell fossil fuel holdings. Big institutions and individuals responsible for $2.6 trillion in assets have done so, according to a September report by philanthropy consultants Arabella Advisors. That's a 50-fold increase in assets under management over last year.

Others have used companies' annual proxy voting process to push for more disclosure on climate risks at Exxon and Shell, for example. And research and lobby groups are corralling investors to take action, too. CDP, for example, gathers data from at least 4,500 firms – not just energy companies – on behalf of more than 800 investors responsible for some $95 trillion of assets.

All in, it puts energy companies in a bind. Those that ignore climate risk – and the willingness of politicians and financial markets to deal with it – could eventually see billions of dollars of investment go up in smoke. Those that forgo investing in fossil fuel altogether, though, may struggle to grow as the rising global population demands a better lifestyle that, currently, only more traditional energy methods can help provide. Whatever happens in Paris, climate will prove more vexing than shale in 2016.

Published November 2015

WON'T GET FOOLED AGAIN

THE FED MAY BE CUTTING RATES AGAIN WITHIN A YEAR
BY ROB COX

The U.S. Federal Reserve is slowly raising the cost of borrowing after seven years of exceptionally loose monetary policy. But by taking so long, there's a danger the central bank under Chair Janet Yellen may need to cut rates again relatively soon. While a swift retreat might be insignificant on paper, the Fed's credibility would suffer.

GDP will grow by 2.3 percent in 2016, according to Goldman Sachs, after expanding 2.5 percent in 2015. The unemployment rate, now at 5 percent, could dip lower, and the rate of inflation is below 2 percent. This all fits the Fed's mandates covering full employment and stable prices, though Yellen

Federal Reserve Chair Janet Yellen speaks at an event hosted by the Economic Club of Washington in Washington, D.C. Dec. 2, 2015. REUTERS/Joshua Roberts et al would prefer stronger price increases. The data-driven picture is not, however, especially robust. It's easy to imagine scenarios which throw a few assumptions about future growth off course.

One possibility is that as U.S. monetary policy diverges from the European Union and Japan, it lifts the dollar further and slams exports. Then, capital flight from emerging markets to safer dollar-denominated assets provokes a crisis, or even defaults, roiling global markets.

Another risk is that the post-2008 recovery cycle and the accompanying market buoyancy turn sharply. Rumbles in the high-yield bond market, including the closure of a Third Avenue Management mutual fund could, in the worst case, be early signs of exactly that.

U.S. and global sentiment, tourism and trade could suffer, too, should Islamic State jihadists carry out further attacks, following murderous sprees in Paris and California and the downing of a Russian passenger airplane over Egypt.

Some of these possibilities are baked into forecasts. Goldman says a euro may buy only $0.85 by the end of 2016, for instance, from about $1.10 recently. And JPMorgan estimates the probability of a recession in 2016 at below 25 percent.

But a combination of unexpected events could alter the forecasts. The Fed could find itself needing to inject stimulus. Yellen wouldn't have much ammunition if rates have only by then made it up to 1 percent, say.

More worryingly, it would look bad for the Fed to reverse course so soon after taking years to get to the point of liftoff. Politicians, including Republican presidential contenders, are already campaigning to curtail the Fed's powers and audit its inner workings. Any appearance of flip-flopping would boost their case.

Published December 2015

OIL WILL BLOW PAST $80 A BARREL IN 2016

BY ANDY CRITCHLOW

The next big move in the price of oil will be up. For now, OPEC producers are flooding the market with cheap crude. But low-cost OPEC producers will win the hydrocarbon price war because they can fight harder for longer. And when they win, the price of oil will rise.

Brent crude has fallen about 40 percent over the last year to less than $40 a barrel as the Organization of the Petroleum Exporting Countries has sought to defend its market share by pumping record volumes of oil and driving profit out of higher-cost production. Shale oil drillers in America and offshore operators in areas such as the UK's North Sea are among the most vulnerable. Improving wellhead efficiency has softened the blows thus far. But these gains will be harder to repeat in 2016.

The International Energy Agency (IEA) expects shale oil production in the United States to shrink by more than 600,000 barrels per day next year if current low oil prices persist. At that rate, daily U.S. shale production would soon fall below 5 million barrels per day.

Lower prices will accelerate shutdowns in areas like the North Sea, too. Energy consultancy Wood Mackenzie reckons that over a third of the area's 330 fields could be threatened by early closure if prices remain below $85 per barrel for an extended period.

Like shale, the North Sea was once seen as a serious rival to OPEC's cheap oil, but now it looks like its first victim. Wood Mackenzie reckons that at least 1.5 million barrels of daily global production are uneconomic at $40. Those volumes make up no more than a couple of percent of supply. But the global oil market is finely balanced. Small changes can lead to big shifts.

As more high-cost production is either shut down or slowed down, OPEC's pricing power will come to the fore. The IEA says oil prices will swill around the bottom of the barrel until 2018. If demand for oil rises with a global economic growth spurt – fuelled perhaps by the low cost of energy – the oil price will move up sooner than that.

The precise price to be seen at any moment in 2016 is unpredictable. But elemental oil market forces suggest that a barrel of black stuff will revert back towards its 10-year mean above $80.

Published December 2015

HOME ECONOMICS CLOUD CLINTON WHITE HOUSE RUN

BY KATE DUGUID

Bill Clinton's 1992 presidential campaign knew to focus on "the economy, stupid." Hillary Clinton, the Democratic front-runner hoping to become America's first female commander-in-chief in November, is ahead in early polls and at the bookies. But GDP and employment gains under President Barack Obama may not be enough to keep Republicans like Donald Trump, Ted Cruz or Marco Rubio at bay.

Hillary Clinton speaks during a news conference at the United Nations in New York on March 10, 2015. REUTERS/Mike Segar

The 1992 campaign unseated Republican George H.W. Bush partly by critiquing his economic record, which included a recession. Obama's 2008 election run coincided with the financial crisis and another downturn under George W. Bush. The economy matters.

This time around, Hillary Clinton is set to win the Democratic nomination over left-wing challenger Bernie Sanders, the senator from Vermont. She's also a better-than-even favorite to win the White House on online betting sites. Polls, though unreliable at this stage, mostly show her winning against Republican rivals.

But all presidential races are close. Clinton's danger may be that Obama's economic record is too tepid. Using a respected predictive model developed by Ray Fair, a Yale University economist, the pace of growth in U.S. GDP per capita would have to run above 4 percent for the first three quarters of 2016 for the Democrat to win 50 percent of the two-party vote.

That would require an even higher overall growth figure, because the population is expanding. Current forecasts – the World Bank's 2.8 percent for U.S. GDP growth in 2016, for example – fall well short. One related factor is that, despite the low 5 percent unemployment rate in November, half the post-crisis high during Obama's first year in office, hourly wage growth is still muted at 2.3 percent year-on-year. Median household income in 2014 remained well below the 2007 peak, according to the Census Bureau – an economic statistic that's close to home for voters.

Fair's model hands the incumbent party an automatic disadvantage when there's no sitting president seeking re-election. That reflects history, but the sample is small and the bias questionable. Plus there's time for wages to pick up: Moody's Analytics, for instance, predicts 3 percent earnings growth in 2016.

It's possible that the Republican who emerges from the fractious Trump-dominated selection process will polarize voters along ideological lines that swamp economic factors. More likely, though, Hillary Clinton's success will rest on improving home economics.

Published December 2015

NUMBERS ADD UP TO HSBC LEAVING LONDON

BY PETER THAL LARSEN AND GEORGE HAY

Data points to HSBC leaving the United Kingdom. The global bank is reviewing the location of its head office based on considerations such as economic importance, transparency and tax. Breakingviews has crunched the numbers to compile its own rankings. Our figures suggest Singapore, Hong Kong and even Canada would be more attractive than HSBC's current home.

The bank has said it is reviewing its location based on 11 criteria. In an attempt to approximate HSBC's approach, Breakingviews compiled statistics for each category. We then used them to rank six cities: London; Hong Kong and Shanghai, where HSBC was founded 150 years ago; and Singapore, Asia's other main financial hub. We included Paris as the most likely destination within the euro zone, since HSBC is big in France but not Germany; and Toronto, home of the bank's largest presence in North America. We then added up all the scores to arrive at an overall ranking.

If economic size and future growth were all that mattered, HSBC would be moving to China. The world's second-largest economy promises by far the biggest potential increase in GDP over the coming years.

Where should HSBC put its head office?

Ranking locations based on the bank's criteria

1 2 3 4 5 6
Best ← → Worst

Overall ranking	1 SINGAPORE	2 HONG KONG	3 TORONTO	4 LONDON	5 SHANGHAI	6 PARIS
Economic size[1]	6	5	4	2	1	3
Existing HSBC presence[2]	6	1	4	3	2	5
Competitiveness[3]	1	2	4	3	6	5
Long-term stability[4]	1	3	2	4	6	5
Transparency[5]	1	4	2	3	6	5
Top talent retention[6]	2	4	1	3	6	5
Comm. environment[7]	1	4	1	3	6	5
Corporation tax	2	1	5	4	3	6
Govt. support[8]	1	1	3	6	3	5
Regulation[9]	1	1	4	3	6	5
Financial impact[10]	6	5	3	1	4	2

[1] Economic importance and future growth (2020 GDP forecast)
[2] Scale of existing HSBC presence (profit/loss before tax in 2014)
[3] Highly competitive economy (WEF Competitiveness Index 2014/15)
[4] Based on Worldwide Governance Indicators, 2014 Update: Political Stability
[5] Corruption Perceptions Index 2014
[6] Ability to attract and retain top talent (IMD World Talent Ranking 2014)
[7] Robust commercial environment (WGI 2014: Rule of Law)
[8] Government policy in support of growth and development of financial services sector
[9] Robust regulatory environment (WGI 2014: Regulatory Quality)
[10] Financial impact for the group based on miles from London

Source: HSBC; KPMG; IMF; World Bank; Transparency International; World Economic Forum; Breakingviews estimates and calculations. REUTERS/Peter Thal Larsen, George Hay

****Click on the graphic to view online, full size graphic.****

REUTERS

But Shanghai scores poorly in matters such as transparency, competitiveness and the rule of law. As a result, the Chinese city finishes near the bottom of the list.

Only Paris does worse. The French capital is less attractive for talented staff, while its corporate tax rate of 33 percent is the highest of the six potential locations.

London finishes fourth. Despite its long-established position as one of the world's largest financial centers, the British capital doesn't stand out on any of the chosen metrics. Even though the government has pledged to phase out the banking levy that was proving so expensive for HSBC, and is lowering the corporate tax rate to 18 percent, a planned 8 percent profit tax surcharge on banks diminishes Britain's appeal.

Toronto, meanwhile, scores surprisingly well. HSBC earned more pre-tax profit in Canada than in the United States last year. The largest Canadian city is joint top of the pack alongside Singapore when it comes to the rule of law, according to the World Bank-backed Worldwide Governance Indicators (WGI), and was also most attractive for attracting and retaining skilled staff, according to the IMD World Talent Ranking.

Less surprising is that Hong Kong is also near the top of the list. HSBC's home until 1994 remains the bank's largest single market, while its proximity to China promises future growth opportunities. The former British colony boasts the lowest corporate tax rate among the contenders, the highest possible score for regulatory quality according to the WGI rankings, and a government that is keen to keep Hong Kong developing as a financial center.

Even so, Singapore just edges out its Asian rival. Despite its small economy and slender contribution to HSBC's bottom line, the city-state comes top in terms of competitiveness, stability and transparency. On several other measures it comes second.

Of course, any such exercise is bound to be much cruder than HSBC's own study. It also attaches equal weight to each factor, whereas the bank may decide some are more important than others. Besides, HSBC hasn't even said which locations are in the running.

The bank's board will also have to weigh up the impact of its decision on the rest of the bank. For example, if it picked Singapore, relocating there would be a massive snub to Hong Kong and China.

Nevertheless, what is clear is that – on the checklist HSBC has laid out – it's hard to make an empirical case for keeping the head office in Canary Wharf. If HSBC does decide to stay put, it will need a strong argument for ignoring data that seems to point east.

Published July 2015

ANNUAL REPORTS OFFER FRONT-PAGE WARNINGS

BY QUENTIN WEBB

Here's a gloomy end-of-year thought: signs of corporate trouble lurk in annual reports – and sometimes you don't even need to look beyond the cover to see the problem.

Take a few recent doorstoppers, adorned with boasts that now seem painful. Drug group Valeant Pharmaceuticals' 2014 shareholder communiqué was entitled "a simple philosophy." That is now under attack. Volkswagen's self-identification with "moving progress" rings hollow after the German carmaker's emissions-testing scandal. And Standard Chartered shares have been "leading the way" downwards ever since those words greeted readers on the bank's 2012 report.

A bit further back, HBOS was "delivering our strategy" while Royal Bank of Scotland was ready to "make it happen." Then the credit crunch made very bad things happen to the two British banks, and any previous strategy wholly undeliverable.

So is it time to sell short the shares of any company bold enough to slap words such as "scaling new peaks" or "strength to strength" on this year's report? Well, maybe. But for every VW there's a Glencore: the commodities house didn't tempt fate with slogans but still came unstuck in 2015. Besides, corporate verbosity is so widespread that any such strategy would struggle to cope with the many false positives: firms that deliver solid performance despite the vacuous slogans on their annual reports.

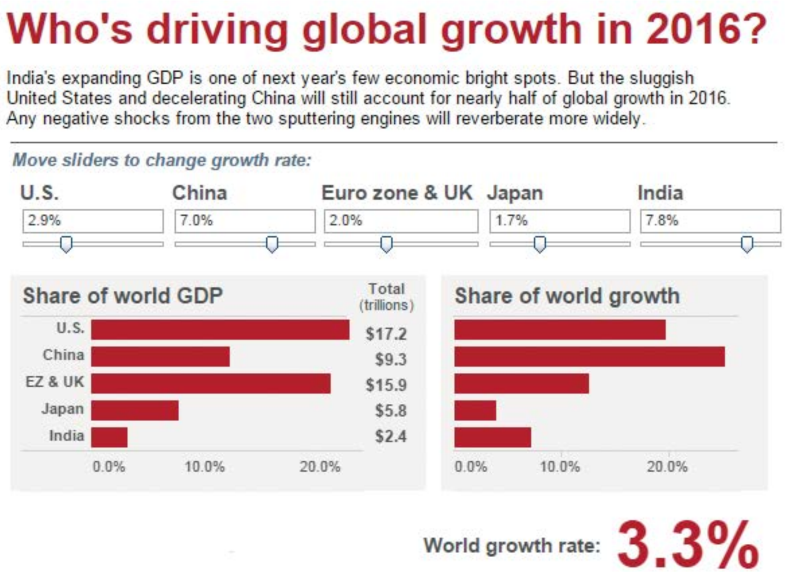
Even so, companies would do better to strike a small blow for plain speaking – and avoid creating a hostage to fortune – by not giving their annual report a title. Then investors can go back to searching for nasty surprises where they belong: in the footnotes.

Published December 2015

GLOBAL ECONOMY DEPENDS ON MORE THAN INDIA IN 2016

BY PETER THAL LARSEN

India will not rescue the global economy in 2016. The subcontinent's expanding GDP is one of next year's few economic bright spots. But Indian output is still too small. Any negative shocks from the sluggish United States and decelerating China will reverberate more widely.



REUTERS/Katy Weber, Peter Thal Larsen, Robyn Mak

****Click on the graphic to view online, interactive version.****

India is finally emerging from China's shadow in the global growth stakes. Helped by a controversial overhaul of its GDP statistics, the Indian economy probably expanded by 7.5 percent in 2015 and is set to swell by a further 7.8 percent in 2016. Contrast that with the People's Republic, which is struggling to maintain the nearly 7 percent pace promised by its leaders.

The prospect of sustained rapid growth has drawn the attention of prominent central bankers. India's economy has "enormous potential" to recharge Asia's growth engine, Stanley Fischer, the U.S. Federal Reserve's vice chairman, declared in a recent speech.

For now, however, the country's economic progress has relatively little impact on the rest of the world – although it is enormously important to India's 1.3 billion citizens. The economy accounts for little more than 3 percent of global output, according to Breakingviews calculations based on World Bank forecasts. China is almost four times as large, while the United States is still responsible for more than a fifth of all economic activity.

On current projections, India will produce about 7 percent of global growth in 2016 while the United States and China will together be responsible for about 45 percent of GDP expansion. Put another way, India's growth rate would need to rise by about 3 percentage points in order to add 0.1 percentage point to next year's expected global growth rate of 3.3 percent. China could have the same impact with a 1 point increase in the pace of expansion. For the United States, an extra half point would suffice.

With Europe stuck in the doldrums and Japan struggling to recover, the world economy still depends heavily on its two largest growth engines, both of which are sputtering. A severe slowdown in China or a stalled recovery in the United States would be felt around the world. By comparison, India's economic performance, no matter how impressive, will barely register.

Published December 2015

NETFLIX WILL BE RECAST FROM ALLY TO VILLAIN

BY JENNIFER SABA

Netflix will be recast in the role of the bad guy next year. The video-streaming service was once derided as the "Albanian army" by Time Warner boss Jeff Bewkes but now is worth roughly the same $55 billion as his company. With some 69 million subscribers worldwide, it may be too late for media bosses to do much about this beast they helped create.

It wasn't long ago when TV and movie producers considered Netflix something of a hero. The company became a new buyer of programming. Now, however, the increasing popularity of Netflix is contributing to the erosion of pay TV, the more lucrative and predictable source of revenue. Consumers are starting to ditch expensive cable bills in favor of a la carte options like Netflix. By 2020, SNL Kagan forecasts that 82 percent of U.S. households will be pay-TV subscribers, down from a peak of 88 percent in 2011.

That's one reason why Bewkes, Twenty-First Century Fox Chief Executive James Murdoch and Walt Disney boss Bob Iger are signaling a change of heart. Murdoch, for instance, said that Fox is going to do more business with Hulu, the Netflix rival jointly owned by Fox, Comcast and Disney. Those decisions may cause other problems. The producers of hit series "Homeland" on CBS-owned Showtime, for example, are concerned they're getting a smaller cut of profit because of deals struck with Hulu, according to the Wall Street Journal.

The industry's wariness may be futile at this point anyway. For one, Netflix's coffers have grown too big. Its increasing scale should enable it to outspend rival networks in 2016. Though in programming Netflix is still catching up to the likes of HBO, which recently signed up "Sesame Street" and Jon Stewart, Morgan Stanley estimates the company led by Reed Hastings will splash out some $2.5 billion next year in the United States, compared with HBO's $1.8 billion and Showtime's $700 million.

Netflix is also scaling up production of original shows like "Master of None" and "House of Cards." That gave it the confidence earlier this year to opt out of renewing a programming deal with Epix, the venture owned by Viacom's Paramount Pictures, and Lions Gate, because it couldn't secure exclusivity. That's a pretty strong show of force by what was once considered an insignificant military operation.

Published December 2015

THE UBER OR AIRBNB OF FINANCE WILL PROVE ELUSIVE

BY ROB COX AND ANTONY CURRIE

Nothing scares chief executives of established businesses like the notion that some millennial whiz kid from Silicon Valley will invent a better mousetrap and, to mix clichés, eat their lunch. Bankers aren't too fussed, though. Their biggest worry is also their greatest protection: regulation.

Banking profit totaled $160 billion in the past 12 months in the United States, according to Federal Deposit Insurance Corporation figures. That explains why investors deposited $15 billion into financial technology companies in the first nine months of 2015, surpassing the $12 billion invested in all of 2014, according to CB Insights data analyzed by Accenture.

Much of that has funded startups embracing innovations in bitcoin's back end, new lending models and payment systems. On their own, some – say, Venmo in payments, Avant in personal lending or Digital Asset Holdings in blockchain – may transform pieces of the financial-services firmament.

But investors hoping for the next Uber, Google or Amazon will be disappointed. Returns will be generated and new millionaires minted, but the fintech industry will find it tough to swipe away banking-industry profit to the extent their more disruptive Silicon Valley cousins have cut earnings in the newspaper, entertainment, taxi and hotel businesses.

Federal government oversight creates a far higher barrier to entry. The more involved a company becomes in handling people's money, the more responsibility – and costs – it must bear. That explains how most high-profile fintech startups choose their niche.

Many lend to people or businesses with subpar credit, which banks avoid for fear of prompting another financial crisis and higher costs imposed by watchdogs. Similarly, entrants in consumer payments must piggyback on existing bank accounts, which they cannot replace without succumbing to regulation.

Fintech firms are certainly developing more efficient and technologically proficient ways of doing business. But they're more likely to partner with, or sell to, larger financial rivals to achieve scale. Several mega-banks like Citigroup and Wells Fargo have already taken stakes.

JPMorgan's recent venture with business lender On Deck Capital is a case in point. Boss Jamie Dimon let slip that his $250 billion bank was working with an unnamed peer-lending outfit. When $760 million On Deck called itself out, its stock surged nearly 40 percent, though it's still down 60 percent since its debut.

That reaction is instructive. It's a sign that the leverage in the fledgling fintech universe is still with the banks, thanks to regulators, not the upstarts.

Published December 2015

GLOBAL SMARTPHONE BRANDS FACE MASS EXTINCTION

BY ROBYN MAK

Smartphone brands are heading for extinction in 2016. The industry's growth rate dipped below 10 percent this year. Apple and Samsung's high-end phones are taking most of the spoils, while upstarts like China's Xiaomi are picking up first-time buyers. Loss-making brands from HTC to Sony may be forced to conclude the game is over.

The smartphone industry grew at a single-digit rate this year for the first time, according to data from IDC. Just two years ago, the industry was expanding at a breakneck 40 percent. Demand from China – the world's largest handset market and once the driver of growth – will be flat this year.

Vice President of Product Strategy and Marketing for Samsung Electronics America Justin Denison speaks in New York Aug. 13, 2015. REUTERS/Andrew Kelly

The slowdown suggests two things. First, the market is saturated: existing smartphone owners outnumber first-time buyers. The People's Republic, which accounts for 30 percent of global shipments, has joined North America and Western Europe to become a replacement market where sales are driven by upgrades.

That's good news for premium handset makers like Apple and Samsung. The $645 billion iPhone maker grabbed a staggering 94 percent of the industry's profits in the three months to September, analysts at Canaccord Genuity reckon. Samsung remains the only big Android phone maker that is profitable.

Second, first-time buyers in emerging markets will power growth. Handset shipments in the Middle East and Africa rose 50 percent year on year in 2015, IDC estimates. Chinese groups Xiaomi and Huawei – which catapulted to third place in shipments this year – have just entered those markets selling budget phones. Fierce battles are also playing out in India, where locals Micromax and Intex are fighting Samsung.

Those without Apple-level margins or Huawei's scale may not survive. The loss-making HTC is already on life support as its $1.3 billion cash pile dwindles. The launch of the group's $500 iPhone rival is unlikely to be a turning point: analysts expect HTC's market share for next year to stay flat at around 1 percent. Ailing Japanese conglomerates, from Sony to Kyocera, will be under pressure to shut down unprofitable mobile units. Even smartphone pioneer BlackBerry may be forced to give up on hardware if sales of its latest model disappoint. 2016 may be the beginning of the end for many.

Published December 2015

HOST BRAZIL MAY CHALLENGE FOR 2016 OLYMPICS GLORY

BY ROBERT COLE

The mighty United States will most likely take top spot once again in the medals table in the 2016 Summer Olympic Games. But a prediction based on population, GDP, the cost of Nikes and past willingness to dope suggests host nation Brazil could break into the top five. Like Team GB in 2012, that will require capitalising on home advantage.

The national flags of Russia, China and Japan will be the others most frequently raised alongside the star-spangled banner as medals from the modern era's 31st Olympiad are awarded, according to Breakingviews' new Olymponomics calculator.

It stands to reason that successful Olympic nations have large populations. That ensures deep pools of raw talent across a wide range of events. Countries with big economies, meanwhile, have the financial resources to equip and train athletes. The cash clout per head may also be relevant, but places like the United States, China, and Russia, which have large resources overall, can direct the biggest sums to train teams of elite sportsmen and women.

National statistics only capture part of the story. Sports participation is critical. The cost of a pair of Nike running shoes is a workable proxy. The rationale is that the cheaper the shoes, the lower the barrier to entry and the greater the likelihood of eventual Olympic success.

Performance can also be enhanced through the illicit use of drugs. Athletes are subjected to stringent anti-doping measures. Cheats, however, may get an outsized share of the spoils if they aren't detected. The Olymponomics calculation uses recent test results from the International Association of Athletics Federations to identify countries that have been more willing to bend and break the rules, and assumes their representatives may be the most likely to succumb to temptation again.

The analysis includes the 20 countries that have been most successful in the last two Olympiads. That excludes some like India, for instance, whose large population and poor record on doping might otherwise have earned it a place nearer the top of the forecast medals table. The idea is that a nation's overall athletic prowess takes time to develop, making past performance relevant as well.

Brazil finished way down the medals table in London four years ago and in Beijing in 2008. In 2016, the home team's green and gold flag may fly a good deal higher.

Published December 2015

Sources: World Bank, NationMaster.com, IAAF. REUTERS/Matthew Weber, Himanshu Ojha, Robert Cole, Richard Beales

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REUTERS

ACKNOWLEDGEMENTS

Production by Kate Duguid and Katrina Hamlin
Graphics by Katy Weber, Matthew Weber, Robyn Mak and Katrina Hamlin
Design by Michael Green, Jonathan Methven and Gavin White

FRONT COVER
A man walks up a spiral staircase at the Museum of Contemporary Art in Chicago, Illinois, Sept. 3, 2014. REUTERS/Jim Young

BACK COVER
Clockwise from top left:
Lightning strikes the Alpine mountains over Garmisch-Partenkirchen as balloons depicting leaders of the G7 countries are inflated June 7, 2015. REUTERS/Wolfgang Rattay

Five hundred replicas of the Storm Trooper characters from Star Wars are seen on the steps at the Juyongguan section of the Great Wall of China, on the outskirts of Beijing, China, Oct. 20, 2015. REUTERS/Jason Lee

Brazil's President Dilma Rousseff speaks during the 15th National Health Conference in Brasilia, Brazil, Dec. 4, 2015. REUTERS/Ueslei Marcelino

A cow is seen near a dry river outside Utrecht, a small town in the northwest of KwaZulu-Natal, Nov. 8, 2015. REUTERS/Siphiwe Sibeko


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