

# Weekly Bulletin

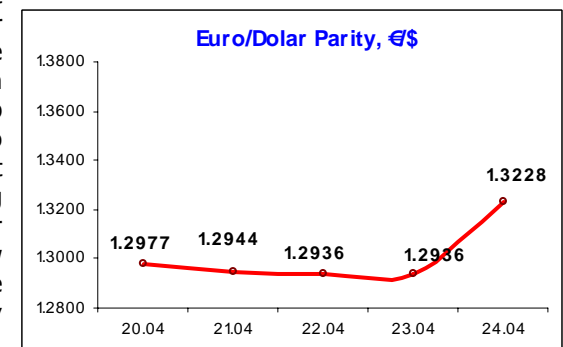
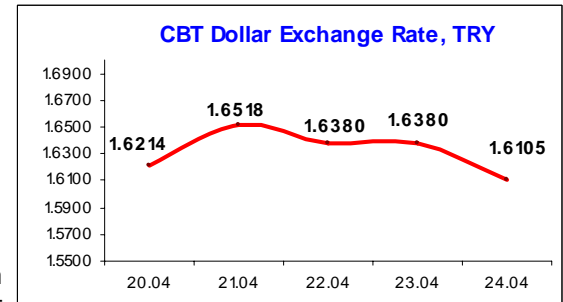
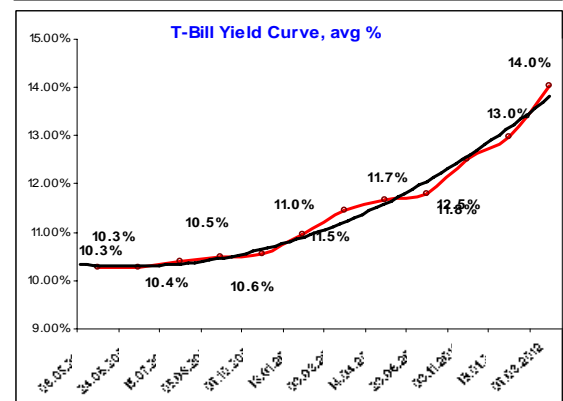
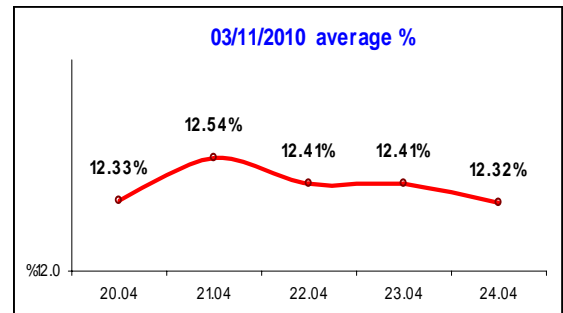
April 27– May 1, 2009

## Focus of this week

- Apr-28** National Security Council  
 CBRT, Minutes of April 16 Meeting  
 US, Consumer Confidence, Apr, cons: 28.8, prev: 26  
 US, S&P Case Shiller home price index, Fed, cons: -18.8%, prev: -18.97%.
- Apr-29** FOMC Meeting, no rate cut is expected current: 0.25%  
 US, Growth, Q1 2009, Adv, cons: -4.9%, prev: -6.3%.  
 US Crude Inventories  
 Japanese markets closed  
 Obama's First 100 day
- Apr-30** Turkstat, Foreign Trade, Mar, cons: \$-1.3bn  
 Treasury, Monthly Borrowing Strategy for May 2009  
 CBRT, Inflation Report (released 4 monthly)  
 US, Personal Income, Mar cons: -0.2%, prev: -0.2%.  
 US, Personal Spending, Mar cons: -0.1%, prev: 0.2%.  
 US, Chicago PMI, Apr, cons: 34%, prev: 31.4%.  
 US, Initial Claims  
 Eurozone inflation, Apr  
 Deadline for Chrysler to merge with Fiat  
 Japanese markets closed  
 US, GM, Q109 EPS, cons: \$-11.07, prev: \$-0.62
- May-1** Turkish Exporters Association, Exports, Apr  
 Istanbul Chamber of Commerce, Inflation, Apr  
 Deadline for non-consolidated Q109 financial results  
 US, ISM Index, Apr, cons: 38, prev: 36.3  
 US, Factory Orders, Mar, cons: %-0.7, prev: %1.8  
 US, Michigan Sentiment Index, Apr, cons: 61.5, prev: 61.9  
 US, Auto sales, Apr

**STRATEGY:** The rate cut was above the consensus estimate, but it is not a total surprise. We toy with the assumption that the CBT will go on for yet another two rounds to deliver a 9% target rate, which would further strengthen the hands of banks. By the way, the financial health of the banking sector is key, and all measures intended to shore up such health ought to be welcome. When the real economy envisages a start-to-run up turn, banking loans should pick up in real terms too. Otherwise, a return to normal or potential growth of c. 4% will remain a dream. The bond market quickly responded to the CBT move. In fact, the CBT emphasized declining risk perception, which in full measure implies the IMF deal is on the table for good this time. On the equity side, we expect profit-taking this week. Now we will look for new hints to emerge from the quarterly inflation report, due Thursday. We like GARAN and HALKB in addition to the weekly recommendation list TSKB Research conveys regularly.

**ECONOMICS:** Although inflation is far from being a concern globally, it is potentially important for the following two reasons. First, monetary history tells us relaxing price stability targets and/or constraints results in lower growth rates and larger output gaps. Second, nominal interest rate smoothing, i.e. minimizing the variance of short rates, combined with minimizing the output gap target leads to inflation getting adrift. Within the



Inflation %	Mar-09	Feb-09	12 month
PPI	0.29	1.17	3.46
CPI	1.1	-0.34	7.89

context of a simple model that admits Calvo pricing, real business cycle-driven growth shocks, a Fisher equation and rational expectations, King & ... have recently demonstrated the presence of a stochastic inflation trend, which furthermore seems to match closely with the U.S. historical time series data. We should add to this the recent IMF Report's findings, and those of Reinhart & Rogoff, which claim, moreover, the recovery can be ill fated at times. For e.g., the real value of government debt tends to steam up, uptrending by a hefty 86% in the major post-WW II episodes. Besides, and this point is important for Turkey as well, the main cause does not lie in rising expenditures or bail-out costs and capital injections that more often than not come under the lime lights for ideological reasons also, but rather in the collapse of tax revenues in the wake of deep and prolonged economic contractions. Rising budget deficits soar further because the revenue side collapses first: see [Carmen M. Reinhart and Kenneth S. Rogoff (2009), "The Aftermath of Financial Crises", NBER Working Paper No. 14656, January].

**POLITICS&VISION:** It is imperative to consider the German and the Italian Conservative Revolutions and to compare them with the advent of Turkish Conservatism in its various guises to come up with a meaningful interpretation and understanding, if not an explanation, of Ankara in the 1980s. We shall tinker with the idea that conservatism, Turkish style, has been overburdened with and over-determined by many an international appellation in addition to symbolic re-readings of images from afar and from a not so distant past. The political elite was imbued with the shades of what has become to be known the Turkish-Islamic Synthesis, and if we go by the book, we would be compelled to admit such synthesis was a strange resultant from ideological vectors that could otherwise have pointed to entirely different directions. Indeed, the military take-over of 1980 clearly facilitated the public admission and the permeability of conservatisms of many sorts, namely the Synthesis and suchlike. A creeping Islamization of ideological configurations that ruled over Ankara's strategic mind took place in the 1980s, first inadvertently and then allegedly under control, and in the end with open force and centrifugal acceleration. In fact, Tanil Bora does not let it pass unnoticed that, in the original interpellation, the (in)famous Turkish-Islamic Synthesis reads as the Turkish-Islamic-Western Synthesis, significant enough to suggest an unmediated continuity with the most established conservative interpretation of Kemalism and modernism in Turkey (Tanil Bora, *Milliyetçiliğin Kara Baharı*, İstanbul 1997, p. 37). This kind of early conservatism looks still blended with the aura of Kemalism in its prime and cuts across the legacies of Ziya Gökalp and Peyami Safa. Was the fully-fledged right turn of the 1980s purely a reaction, or an open ideological counter-revolution in the minds of those who were meant to rule, or was it the logical continuation of a deeply entrenched current of thought that previously was anchored to the right wing of Kemalism in its subprime?

**FIXED INCOME & CURRENCY:** USD/TRY started the week at 1.6150, which moved within the interval of 1.6050-1.6350 in the last trading of the week. Our forecast band for interbank dollar quotation is 1.60-1.6350. Benchmark bond rate completed last week at 12.23% after being traded within 12.40%-12.19% on Friday. Starting at 12.30% in OTC, we envisage benchmark bond to hover around 12.50%-12.10%.

**EQUITY:** The breakthrough came at the end of a 33% increase of 5 weeks long advance from 22,500. If we count from the lowest level of this 18 month period, 20,900, the index has gained 43% in the last 5 months since November, which came only after 64% loss from the record high level of 58,200, and

April 2009– Monthly Domestic Debt Service			
Date	To the Markets	Other	TOTAL
1-April	3,803	503	4,307
8-April	2,678	62	2,740
15-April	88	1	89
22-April	1,216	28	1,244
29-April	67	8	74
<b>TOTAL</b>	<b>7,851</b>	<b>602</b>	<b>8,453</b>

recovered 24% of the loss. The markets had been surging for the last six weeks after hitting down 22,500, with only intra profit takings of 2-3 days. The ISE100 index has tested its 200-day moving average after breaking through its 18 month long declining trend last week. Hence, last week the markets completed the seventh week on the winning streak with a decline in the momentum. The ISE100 index has tested to soar above 29,700 last week, including Friday. The index closed the week at 29,675 with 2.48% daily advance while the weekly gain was limited at 0.78%. The index retreat more than 6% in the first days of the week down to 28,000 and recovered from the weekly low, showing that the short term increasing trend remains intact. The euro/dollar parity moving in favour of dollar also helped the dollar gaining value against lira, up to 1.6700. Together with the change in trend in the parity, the lira also gained strength with rating at 1.6100. The US markets surged 1.5-2.5% on Friday ahead of the initial announcement on the US banks' stress test methodology. The announcement did not provide the details expected from the market but underlined that most of the system is well capitalized. The swine flu alarm has stressed the markets more than the economic agenda at the start of the week as the US futures are trading with more than 1.5% loss. The markets will be watching the US firms' first quarter results together with the last days of Chrysler ahead of the due date set for the firm by the government to set their long term plans to survive. The most hectic data of the week will be the initial release of the first quarter GDP of US on Wednesday. FOMC meeting, together with the home prices and ISM index will also drag attention. The local markets will also watch for comments from the State Minister Şimşek after his meeting with the IMF officials and quarterly inflation report of the Central Bank of Turkey. The ISE100 index is expected to retreat together with the foreign markets. The lack of global enthusiasm or more certainty on IMF talks will limit the efforts for an advance over the 200 day moving average at 29,800. The support levels of the index will be at 29,100 – 28,900. In case of declining below 28,900, the index may tumble down to 28,200.

Gündüz Fındıkçioğlu, PhD

Classical finance theory gives no role to *investor sentiment*. Investors are rational and diversify to optimise the statistical properties of their portfolios. Competition among them leads to an equilibrium in which prices equal the rationally discounted value of expected cash flows, and in which the cross-section of expected returns depends on the cross-section of systematic risks. ***Even if some investors are irrational, classical theory argues, arbitrageurs will offset their demands and similar conclusions for prices will obtain.*** Nonetheless, there is evidence that investor sentiment actually has strong effects on the cross-section of stock prices. Given that a *mispricing* is the result of an uninformed demand shock in the presence of a binding arbitrage constraint, a broad-based wave of sentiment is predicted to have cross-sectional effects, as opposed to raise or lower all prices equally, when either sentiment-based demands vary across stocks or arbitrage constraints vary across stocks. In practice, these two channels lead to quite similar predictions, because stocks that are likely to be most sensitive to speculative demand –those with highly subjective valuations– also tend to be the riskiest and costliest to arbitrage. ***Concretely, then, theory suggests two separate channels through which the stocks of newer, smaller, highly volatile firms, firms in distress or with extreme growth potential, firms without dividends, and firms with like characteristics, would be expected to be relatively more affected by investor sentiment.*** Because cross-sectional patterns of *sentiment-driven mispricing* would be difficult to identify directly, it is advisable to look for hypothesized patterns in *subsequent* stock returns that appear when one conditions on proxies for beginning-of-period investor sentiment. The idea is that conditional cross-sectional patterns in subsequent returns may represent the initial patterns of mispricing correcting themselves over time. ***For example, relatively low future returns on young firms when sentiment was measured to be high suggest that young firms were overvalued ex ante.*** As usual, there is a joint hypothesis problem with this approach. One must also consider the possibility that any such predictability patterns are compensation for systematic risks. The first step is to gather proxies for investor sentiment to use as time series conditioning variables. One may use a number of proxies suggested by recent work, and also construct a novel composite index based on their first principal component. To further reduce the likelihood that these proxies are connected to systematic risks, orthogonalizing each of them to a wide range of macroeconomic conditions is warranted. In recent papers, the resulting sentiment proxies are highly correlated and visibly line up with anecdotal accounts of past bubbles. The cross-section of stock returns varies with beginning-of period sentiment in the predicted manner.

One method is to sort firm-month observations according to the level of sentiment, first, and then the deciles rank of a given firm characteristic, second. ***When sentiment is low -below sample median, small stocks earn particularly high subsequent returns.*** When sentiment is high -above median, there is no size effect at all. Conditional patterns are even sharper when sorting on other characteristics. ***When sentiment is low subsequent returns are higher on young stocks than older stocks, high-return volatility than low-return volatility stocks, unprofitable stocks than profitable ones, and non-payers than dividend payers.*** When sentiment is high, these patterns *completely reverse*. In other words, several characteristics that were not known to have -and do not have- any unconditional predictive power actually reveal sign-flip patterns, in the predicted directions, when one conditions on sentiment. The sorts also suggest that sentiment affects extreme growth and distressed firms in similar ways. When stocks are sorted into deciles by sales growth, book-to-market, or external financing activity, growth and distress firms tend to lie at opposing extremes, with more stable firms in middle deciles. ***Recent research finds that when sentiment is low, the subsequent returns on stocks at both extremes are especially high relative to their unconditional average, while stocks in middle deciles are less affected by sentiment. This U-shaped pattern in the conditional difference of subsequent returns also appears consistent with theoretical predictions, because both extreme growth and distressed firms are likely to have relatively subjective valuations and to be relatively hard to arbitrage.*** Note that this pattern is averaged away in unconditional studies.

***So, it is advisable to look for small caps, young stocks, and high-return volatility stocks. It is clearly the case that the exogenous shocks felt in all emerging markets lies in the origin, but that part of the story is locally narrated.*** A strong political and an economic anchor are both needed shortly. We have just witnessed that players in international markets make their adjustments very quickly, in a textbook fashion where realignments are instantaneous. Nervousness in the bond market will translate immediately to the stock market. And currency is back in as a player, a thing that complicates matters in an unwelcome way.

# TSKB

## Research

research@tskb.com.tr  
MECLISI MEBUSAN CAD. NO 81  
FINDIKLI ISTANBUL 34427, TÜRKİYE  
(90) 212 334 50 50 fax: (90) 212 334 52 34

## TSKB Research

Gündüz Fındıkçıoğlu	<i>Head of Research</i>	(Economy, Strategy, Banking, Leasing, Cement, Automotive)	+90 (212) 334 52 71	<a href="mailto:findikciog@tskb.com.tr">findikciog@tskb.com.tr</a>
Şebnem Mermertaş	<i>Manager</i>	(Conglomerates, Telecom, Media, Energy, Steel, Airline Services)	+90 (212) 334 53 60	<a href="mailto:mermertass@tskb.com.tr">mermertass@tskb.com.tr</a>
Sibel Alpsal	<i>Senior Analyst</i>	(Banking, Insurance, Consumer Durables, Retail, REIT)	+90 (212) 334 53 65	<a href="mailto:alpsala@tskb.com.tr">alpsala@tskb.com.tr</a>
Okan Uzunoğulları	<i>Analyst</i>	(Textile, Food & Beverage, Petrochemicals)	+90 (212) 334 53 23	<a href="mailto:uzunoqullario@tskb.com.tr">uzunoqullario@tskb.com.tr</a>
Başar Yıldırım	<i>Analyst</i>	(Economy, Fixed Income Securities, Automotive, Data Analysis)	+90 (212) 334 52 59	<a href="mailto:yildirimb@tskb.com.tr">yildirimb@tskb.com.tr</a>
Bahar Şenol	<i>Junior Analyst</i>	(Cement, Pharmaceuticals, Economy)	+90 (212) 334 51 52	<a href="mailto:senolb@tskb.com.tr">senolb@tskb.com.tr</a>

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Industrial Development Bank of Turkey

Meclisi Mebusan Caddesi, No:81 34427 Fındıklı/İstanbul

Phone: +90 (212) 334-5340

Fax: +90 (212) 243-2975

Email: [research@tskb.com.tr](mailto:research@tskb.com.tr)

Homepage: [www.tskb.com](http://www.tskb.com)