

# ML Lifestyle Index: Feb-08 Review

Equity | Europe | Luxury Goods  
20 February 2008



## Scheduled review of index constituents

The semi-annual review of the ML Lifestyle Index was held last week. Six of the 50 constituents were replaced and 44 stayed in the index. The additions were Abercrombie & Fitch, J Crew, Lululemon Athletica, Shangri-La, Lindt & Spruengli and Rémy Cointreau. Blue Nile, Timberland and Bang & Olufsen have come out of the index due to tradability constraints (market cap was below the US\$ 1Bn limit). The Gap, Electrolux and Intercontinental Hotels Group were determined not to be relevant to the lifestyle theme anymore, and consequently removed.

## How resilient is luxury within lifestyle?

About half of ML Lifestyle Index weighting consists of luxury goods/services companies. Therefore, we often get asked by investors these days how resilient would the luxury goods sector prove to be to a global synchronised economic downturn. And it is important in our opinion to stress that the sector cannot defy economic gravity even if ultimately luxury tends to generally outperform most consumer categories. We present a proprietary model which allows us to justify our current forecasts on industry revenue growth.

## Luxury & Lifestyle - index description

The ML Lifestyle Index provides investors with exposure to stocks strongly associated with luxury and lifestyle brands globally. Stocks are selected from a wide range of developed market sectors including leather goods & fashion, eyewear, watches and jewellery, wines and spirits but also HNWIs service providers, leisure & recreation and lodging and gaming to name a few. They are screened for liquidity and size to ensure the index has a high level of tradability.

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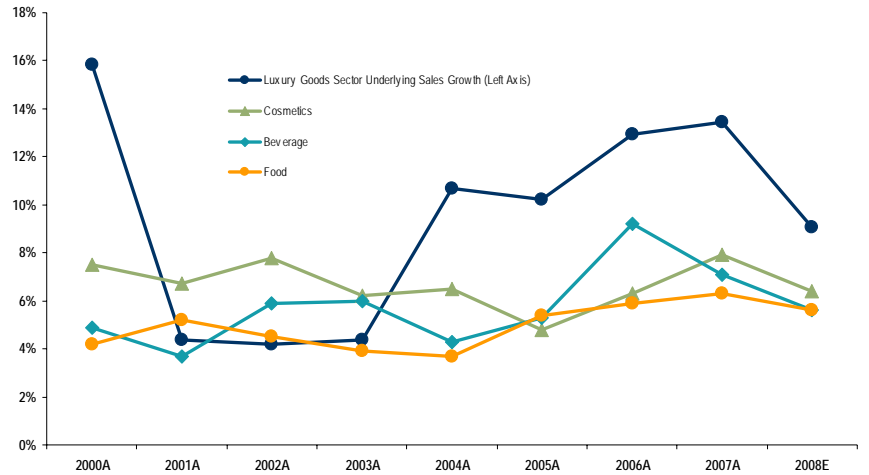
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On the one hand, the luxury goods sector never defies economic gravity but on the other hand it tends to generally grow faster than consumer goods

## Reality check on sector resilience

We often get asked whether the luxury goods sector is resilient to a decelerating world economy. And the shortcut answer is that it does not defy economic gravity and always decelerates when the global economy is softening. Yet, a closer analysis of the sector top line growth suggests that it usually grows faster than most consumer goods segments, at least if one excludes exogenous shocks like 9/11.

Chart 1: Sales Growth for Key Consumer Goods Segments



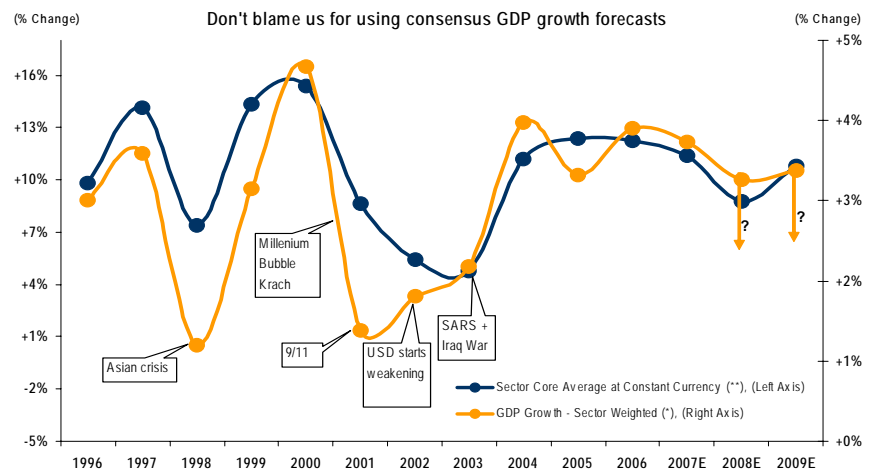
Source: Merrill Lynch - \* Core average includes Bulgari, Hermès, LVMH, Richemont, Swatch Group and TOD's Group (proxy for sector here)

On average 1 percentage point of GDP growth translates to 3 percentage points of growth for the sector

More specifically, the relationship between the sector's organic (constant currency and constant perimeter) sales growth and sector-weighted GDP growth is broadly stable, averaging 3:1 in the past decade. In other words, cyclical sector patterns consistent with the enlargement of the spectrum in price points in recent years cannot be denied. However, long-term growth drivers such as the emergence of new clienteles, the bi-polarisation of spending and the increasing appetite of young generations for brands are also well in place. Our base case scenario presented below is consistent with consensus GDP growth forecasts.

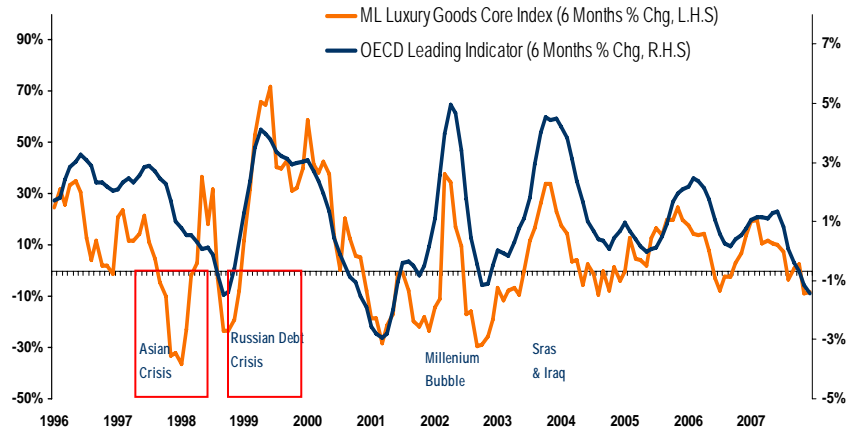
Unless the world economy enters a protracted and synchronised recession, the probability of low single digit top line growth (or a substantial drop in operating income) for the sector is negligible

Chart 2: Luxury Goods constant currency sales usually growth 3x faster than GDP



Source: Merrill Lynch Merrill Lynch and Company Data, (\*) Based on GDP growth expectations for 31 countries weighted according to their contribution to sector sales, (\*\*) Core average includes Bulgari, Hermès, LVMH, Richemont, Swatch Group and TOD's Group

**Chart 3: Strong correlation with the Merrill Luxury Goods Index and the OECD indicator**



Source: Datastream & Merrill Lynch estimates

## The ML Lifestyle Index

The ML Lifestyle Index was launched in April 2007; see “Launching the ML Lifestyle Index”, 12-Apr-2007. The index provides exposure to stocks strongly associated with the luxury and lifestyle brands. Stocks are selected from a wide range of developed market sectors including automobiles, beverages, financial services, travel and retail. Stocks are screened for liquidity and size to ensure the index has a high level of tradability.

### Selection of constituents

The composition of the index is reviewed twice a year, on the first trading day of February and August. The index review is carried out by a committee of analysts, the Lifestyle index Committee. After consultation with the relevant ML industry analysts around the world, the committee identifies stocks that have meaningful exposure to the luxury and lifestyle theme.

The eligible universe of stocks is screened to ensure liquidity and tradability according to the following three constraints:

- Liquidity: the six-month average daily turnover must be at least US\$ 5Mn
- Market capitalisation: the full market cap must be at least US\$ 1Bn
- Country of listing: Stocks must have a main listing in a developed market (according to major international global index providers)

All stocks that pass the above screening are selected as index constituents. However, at least fifteen stocks and at most fifty stocks will be included in the index. Should fewer than fifteen stocks pass the above screening, the size, and subsequently liquidity, constraints may be relaxed. If more than fifty stocks pass the screening, then the fifty most liquid will be selected. The committee will aim to represent all sub-sectors in the universe by at least one stock.

The new index composition is implemented on the close of the fifth trading day after the review (i.e. on the close of the sixth trading day of February and August). The index is equally weighted as of that date.

The index is calculated daily on a price return basis (i.e. no dividends re-invested) and published on Bloomberg under the tickers MLEILIFD (US\$) and MLEILIFE (EUR).

In addition to the above functions, the ML Lifestyle Index Committee will have the following responsibilities:

- Ensure the rules of the index remain relevant following any significant changes in the luxury and lifestyle sectors or related theme.
- Decide on extending the implementation of changes to the index from one trading sessions to any period up to five trading sessions. This will be done in the event that a material increase in the liquidity/capacity of the index is required in order to minimise market impact. Any such decisions will be announced in advance.
- In addition, the committee may decide to include large IPOs with trading history of less than six months on a ‘fast-entry’ basis without waiting for the next index review if it believes such stock may have a significant impact on the theme.

- Moreover, the committee may also exercise discretion on the treatment of non-standard corporate events (e.g. take-overs of constituents by non-constituents, spin-offs, etc) that may impact the relevance of the index to the investment theme.

### The February review introduces six new names

The semi-annual review of the ML Energy Efficiency Index was held on 1-Feb-08 in order to determine the composition and weighting of the index for the next six months, i.e. until the next review due in Aug-2008. Out of a total of 50 companies, 44 remain in the index while six new companies are added. Consequently, the February composition still consists of 50 names. The implementation of the review took place on the close of 13-Feb-08. The new entrants were Abercrombie & Fitch (United States), J Crew (United States), Lululemon Athletica (United States), Shangri-La (Hong Kong), Lindt & Spruengli (Switzerland) and Rémy Cointreau (France).

Table 1: Companies added to the index

Ticker	Name	Country	Market Cap (USD Mn)	Liquidity (USD Mn)*	Reason for addition**
ANF US	Abercrombie & Fitch Co-Cl A	United States	7,070	158.6	Added to Universe
JCG US	J Crew Group Inc	United States	2,881	62.8	Added to Universe
LULU US	Lululemon Athletica Inc	United States	1,626	41.4	Added to Universe
69 HK	Shangri-La Asia Ltd	Hong Kong	8,019	12.4	Market Cap above US\$ 1Bn
LISN SW	Lindt & Spruengli Ag-Reg	Switzerland	4,409	9.0	Market Cap above US\$ 1Bn
RCO FP	Remy Cointreau	France	2,761	6.8	Market Cap above US\$ 1Bn

Source: Merrill Lynch Equity Derivatives Strategy

\* Average daily value traded over the past 6 months

\*\* We highlight the change that led to addition since the previous review

Blue Nile, Timberland and Bang & Olufsen have come out of the index due to tradability constraints (market cap was below the US\$ 1Bn limit). After consultation with the relevant ML industry analysts; The Gap, Electrolux and Intercontinental Hotels Group were determined not to be relevant to the lifestyle theme anymore, and consequently these companies were removed from the index.

Table 2: Companies deleted from the index

Ticker	Name	Country	Market Cap (USD Mn)	Liquidity (USD Mn)*	Reason for deletion**
GPS US	Gap Inc/The	United States	14,528	176.6	Not relevant to Lifestyle theme
ELUXB SS	Electrolux Ab-Ser B	Sweden	4,751	75.1	Not relevant to Lifestyle theme
IHG LN	Intercontinental Hotels Grou	United Kingdom	4,527	68.5	Not relevant to Lifestyle theme
NILE US	Blue Nile Inc	United States	954	49.7	Market Cap below US\$ 1Bn
TBL US	Timberland Co-Cl A	United States	864	12.3	Market Cap below US\$ 1Bn
BOB DC	Bang & Olufsen A/S- B Shs	Denmark	691	8.5	Market Cap below US\$ 1Bn

Source: Merrill Lynch Equity Derivatives Strategy

\* Average daily value traded over the past 6 months

\*\* We highlight the change that led to deletion since the previous review

The ML Lifestyle Index composition as of the Feb-08 review is shown in the table below. This composition will remain unchanged (barring any corporate actions) until the next semi-annual review, scheduled in Aug-08. The table also includes the market cap, liquidity (six-month average daily turnover) and the 12-month trailing dividend yield of each constituent, all measured as of the latest review date (1-Feb-08). Based on the individual stock trailing dividend yields, we calculate the 12-month trailing dividend yield of the index to be 1.46% (1.65% including special dividends). The country, regional and sector weights of the current index composition are shown in Charts 4, 5 and 6. The regional allocation to Europe, North America and Pacific Rim is 48%, 42% and 10% respectively.

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Table 3: The February 2008 composition of the ML Lifestyle Index

Ticker	Name	Country	Sector (ICB Super sector)	Market Cap (USD Mn)	Liquidity (USD Mn) *	Dividend Yield **	Weight	Change
MC FP	Lvmh Moet Hennessy Louis Vui	France	Personal & Household Goods	51,651	215.2	2.04%	2.00%	--
OR FP	L'Oreal	France	Personal & Household Goods	76,388	198.6	1.41%	2.00%	--
PP FP	Ppr	France	Retail	18,485	135.6	3.08%	2.00%	--
RI FP	Pernod-Ricard Sa	France	Food & Beverage	23,122	100.1	1.77%	2.00%	--
RMS FP	Hermes International	France	Personal & Household Goods	11,002	40.7	1.36%	2.00%	--
CDI FP	Christian Dior	France	Personal & Household Goods	20,292	30.0	1.95%	2.00%	--
RCO FP	Remy Cointreau	France	Food & Beverage	2,761	6.8	2.98%	2.00%	Addition
BMW GY	Bayerische Motoren Werke Ag	Germany	Automobiles & Parts	33,396	267.2	1.87%	2.00%	--
POR3 GY	Porsche Automobil Hldg-Pfd	Germany	Automobiles & Parts	15,921	266.3	0.57%	2.00%	--
ADS GY	Adidas Ag	Germany	Personal & Household Goods	13,118	130.5	0.97%	2.00%	--
PUM GY	Puma Ag	Germany	Personal & Household Goods	5,839	23.4	1.02%	2.00%	--
330 HK	Esprit Holdings Ltd	Hong Kong	Retail	16,718	64.8	1.62%	2.00%	--
69 HK	Shangri-La Asia Ltd	Hong Kong	Travel & Leisure	8,019	12.4	1.15%	2.00%	Addition
LUX IM	Luxottica Group Spa	Italy	Personal & Household Goods	13,153	55.7	2.19%	2.00%	--
BUL IM	Bulgari Spa	Italy	Personal & Household Goods	3,514	26.1	3.67%	2.00%	--
TOD IM	Tod'S Spa	Italy	Retail	1,841	11.9	3.07%	2.00%	--
BEN IM	Benetton Group Spa	Italy	Personal & Household Goods	2,548	11.6	3.93%	2.00%	--
6758 JP	Sony Corp	Japan	Personal & Household Goods	45,328	426.4	0.52%	2.00%	--
4911 JP	Shiseido Co Ltd	Japan	Personal & Household Goods	9,638	44.4	1.32%	2.00%	--
8238 JP	Isetan Co Ltd	Japan	Retail	2,571	30.5	1.16%	2.00%	--
ITX SM	Inditex	Spain	Retail	32,271	209.8	2.41%	2.00%	--
HMB SS	Hennes & Mauritz Ab-B Shs	Sweden	Retail	41,359	211.7	3.19%	2.00%	--
CFR VX	Cie Financiere Richemon-Br A	Switzerland	Personal & Household Goods	30,306	170.2	1.66%	2.00%	--
BAER VX	Julius Baer Holding Ag-Reg	Switzerland	Financial Services	16,331	133.8	0.63%	2.00%	--
UHR VX	The Swatch Group Ag-Br	Switzerland	Personal & Household Goods	8,672	90.6	1.18%	2.00%	--
LISN SW	Lindt & Spruengli Ag-Reg	Switzerland	Food & Beverage	4,409	9.0	0.81%	2.00%	Addition
DGE LN	Diageo Plc	United Kingdom	Food & Beverage	52,395	274.6	3.52%	2.00%	--
CCL LN	Carnival Plc	United Kingdom	Travel & Leisure	7,292	85.4	3.47%	2.00%	--
BRBY LN	Burberry Group Plc	United Kingdom	Personal & Household Goods	3,853	49.3	2.69%	2.00%	--
AAPL US	Apple Inc	United States	Technology	117,550	6,557.8	--	2.00%	--
WYNN US	Wynn Resorts Ltd	United States	Travel & Leisure	13,356	303.6	--	2.00%	--
COH US	Coach Inc	United States	Personal & Household Goods	12,016	241.3	--	2.00%	--
NKE US	Nike Inc -CI B	United States	Personal & Household Goods	24,519	222.7	1.26%	2.00%	--
JWN US	Nordstrom Inc	United States	Retail	9,223	208.9	1.36%	2.00%	--
ANF US	Abercrombie & Fitch Co-CI A	United States	Retail	7,070	158.6	0.85%	2.00%	Addition
HOT US	Starwood Hotels & Resorts	United States	Travel & Leisure	9,302	157.5	1.93%	2.00%	--
MGM US	Mgm Mirage	United States	Travel & Leisure	22,109	155.3	--	2.00%	--
AVP US	Avon Products Inc	United States	Personal & Household Goods	15,390	135.2	2.06%	2.00%	--
TIF US	Tiffany & Co	United States	Retail	5,189	133.2	1.27%	2.00%	--
RL US	Polo Ralph Lauren Corp	United States	Retail	3,567	124.9	0.33%	2.00%	--
HOG US	Harley-Davidson Inc	United States	Automobiles & Parts	9,888	122.8	2.59%	2.00%	--
TOL US	Toll Brothers Inc	United States	Personal & Household Goods	3,719	108.1	--	2.00%	--
BID US	Sotheby'S	United States	Retail	2,145	99.8	1.55%	2.00%	--
RCL US	Royal Caribbean Cruises Ltd	United States	Travel & Leisure	9,348	78.0	1.43%	2.00%	--
EL US	Estee Lauder Companies-CI A	United States	Personal & Household Goods	8,666	68.8	1.23%	2.00%	--
JCG US	J Crew Group Inc	United States	Retail	2,881	62.8	--	2.00%	Addition
SKS US	Saks Inc	United States	Retail	2,599	51.6	--	2.00%	--
LULU US	Lululemon Athletica Inc	United States	Personal & Household Goods	1,626	41.4	--	2.00%	Addition
STZ US	Constellation Brands Inc-A	United States	Food & Beverage	4,172	38.3	--	2.00%	--
FOSL US	Fossil Inc	United States	Personal & Household Goods	2,413	32.2	--	2.00%	--

Source: Merrill Lynch Equity Derivatives Strategy

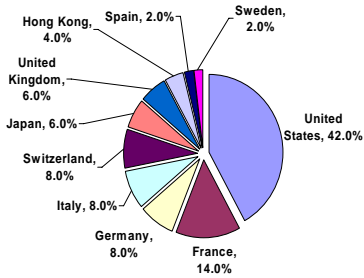
Weight as of 13-Feb-08 close

\* Average daily value traded over the past 6 months

\*\* Trailing 12 month dividends (excluding special dividends)

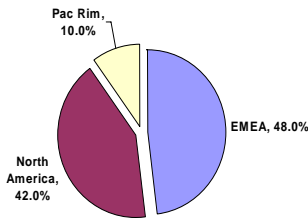
Also, based on the liquidity numbers shown we are able to estimate the overall liquidity of the index. We calculate that a US\$ 500Mn programme trade across all the names in the index would on average represent 22% of the average daily volume per stock. This implies that one day's normal volume in the index would, on aggregate, represent a US\$ 2.3Bn trade.

**Chart 4: Country Breakdown**



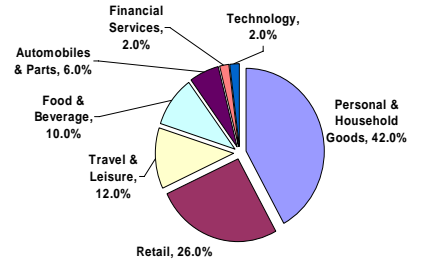
Source: Merrill Lynch Equity Derivatives Strategy

**Chart 5: Regional breakdown**



Source: Merrill Lynch Equity Derivatives Strategy

**Chart 6: Sector (ICB Super Sector) breakdown**



Source: Merrill Lynch Equity Derivatives Strategy

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