



## The Case for buying European equities in 2013 ?

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# Navigating the current environment

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## Good news

- US housing market showing signs of life, consumer in better spirits
- Central banks committed to boosting asset prices
- New regime in China raises prospects of stimulus

## Bad news

- US fiscal cliff threatens to tip economy into recession
- Europe condemned to another year of pitiful economic performance
- Risk of crisis remains, likely candidates are Spain and Greece
- Deleveraging forces continue to hold back developed economies for the foreseeable future

## Why European equities now ?

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- The market is trading at an attractive valuation historically and relative to other assets such as bonds
- Cash flows are healthy and balance sheets are strong, yet cash balances are earning little
- M&A activity is likely to be a feature
- Whilst problems in some countries have caused euro weakness this benefits a number of exporting companies, particularly in northern Europe
- Despite tough macroeconomic conditions, it is still very possible to find companies, even in the peripheral eurozone – There are great opportunities.

## Why smaller companies

- Small cap earnings tend to grow faster than large cap earnings over the long-term.
- This is particularly true in terms of our expectations for growth in 2013.

The housing recovery continues, held back by fiscal uncertainty

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**Improved optimism amongst Builders suggests higher Sales and Construction ahead**

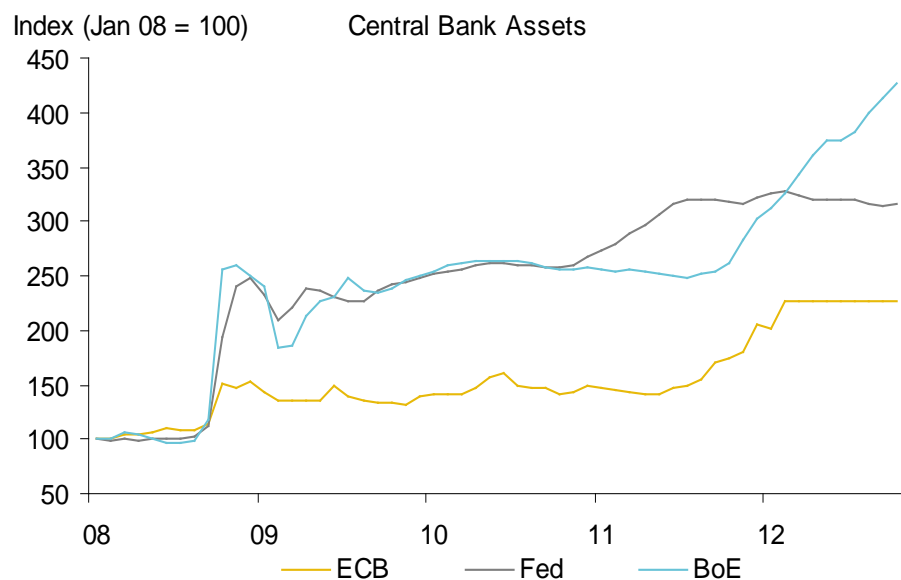
# Consumers feeling better about life for the first time since the crisis

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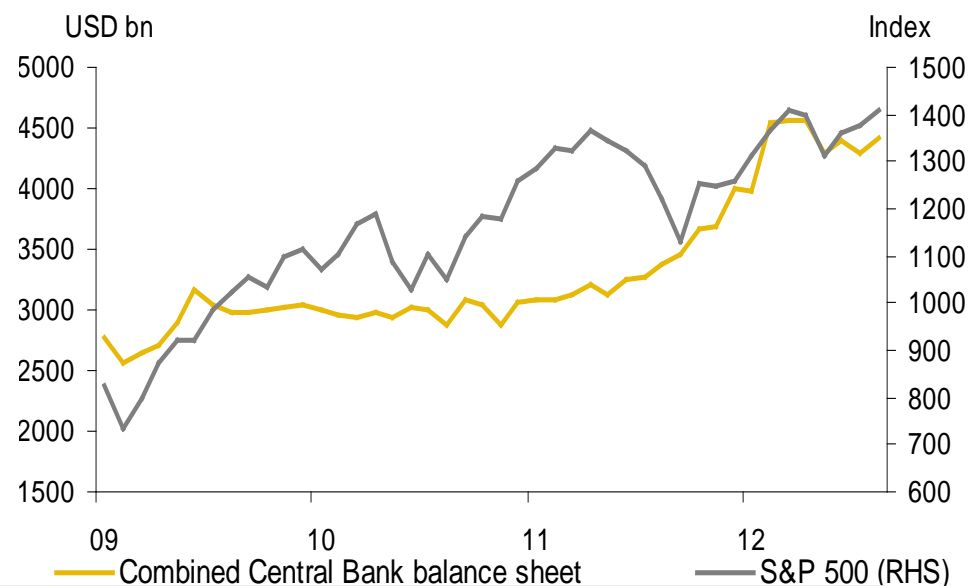
Source: Reuters Ecowin, October 2012.

# Central Bank policy: Who needs growth anyway?

## Central bank balance sheets (rebased, Jan 08 = 100)



## Central bank balance sheets v S&P 500

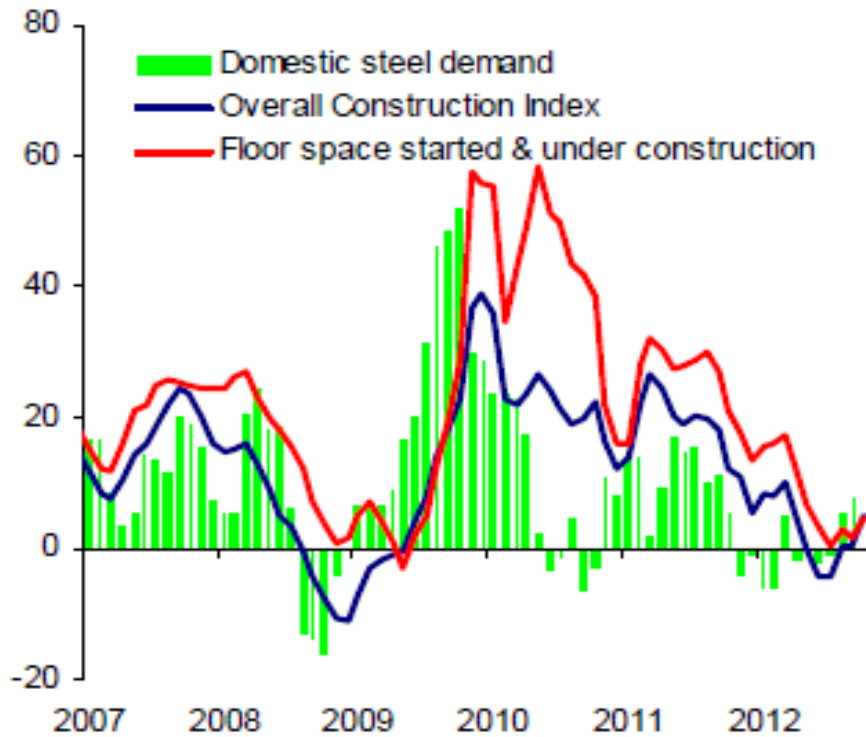


“...lower mortgage rates will make housing more affordable and allow more homeowners to refinance. Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending.” *Ben Bernanke, November 2010*

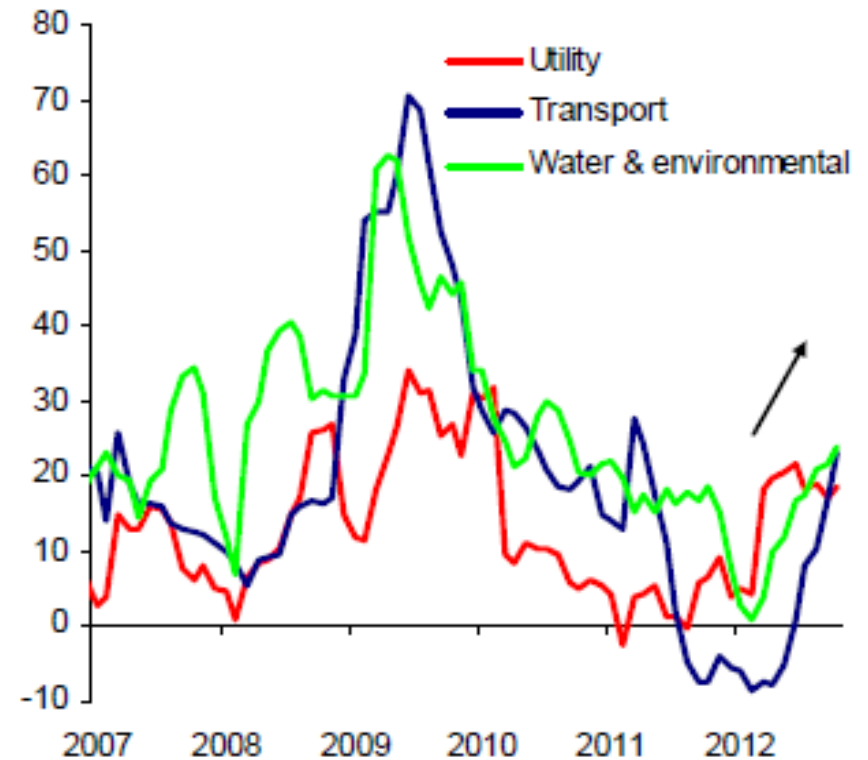
Source: Threadneedle, Bloomberg, Reuters Ecowin, October 2012, Combined balance sheet = ECB + Federal Reserve + Bank of England.

# Tentative signs of improvement in China

## Growth rate (% y/y)



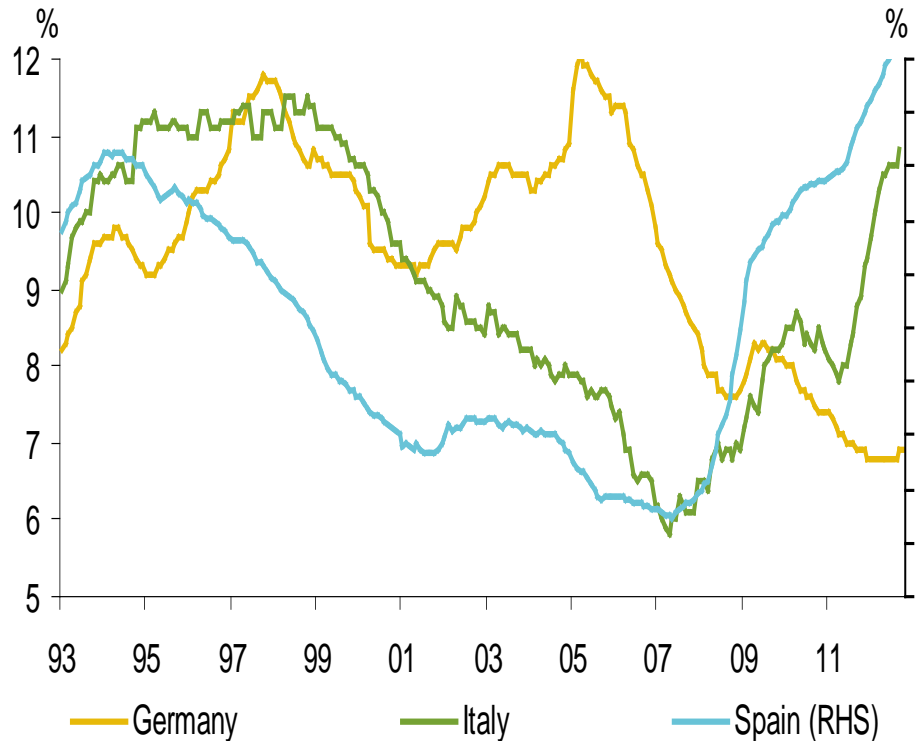
## Growth of infrastructure investment (% y/y 3mma)



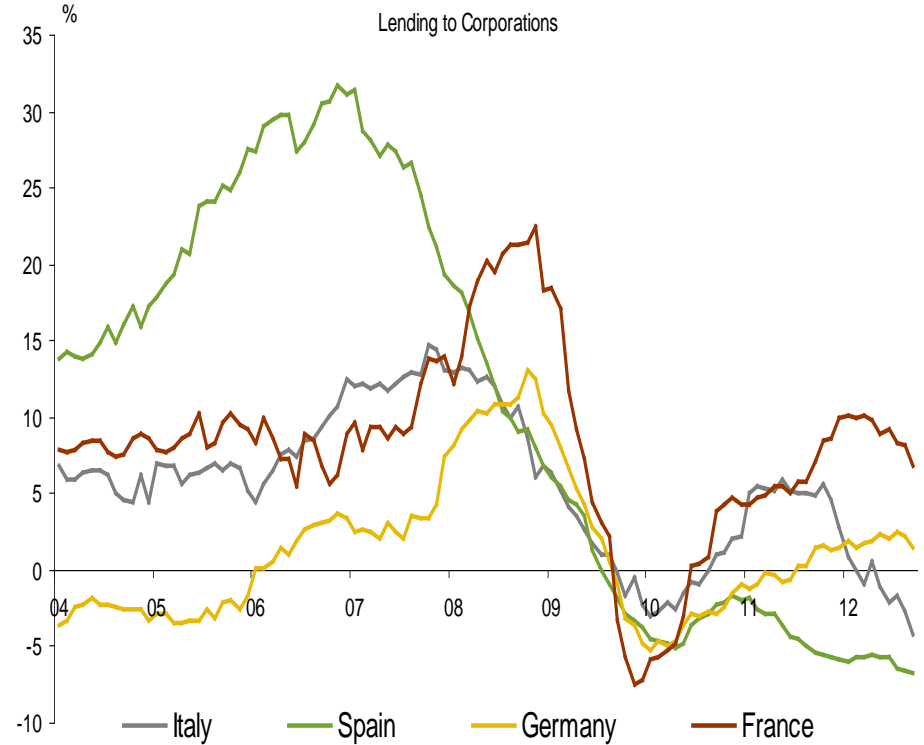
Source: Threadneedle, UBS, October 2012

# Growth divergence is not new, but cannot continue

## Eurozone Unemployment Rates



## Corporate loan growth, %YoY



Time for decisive action

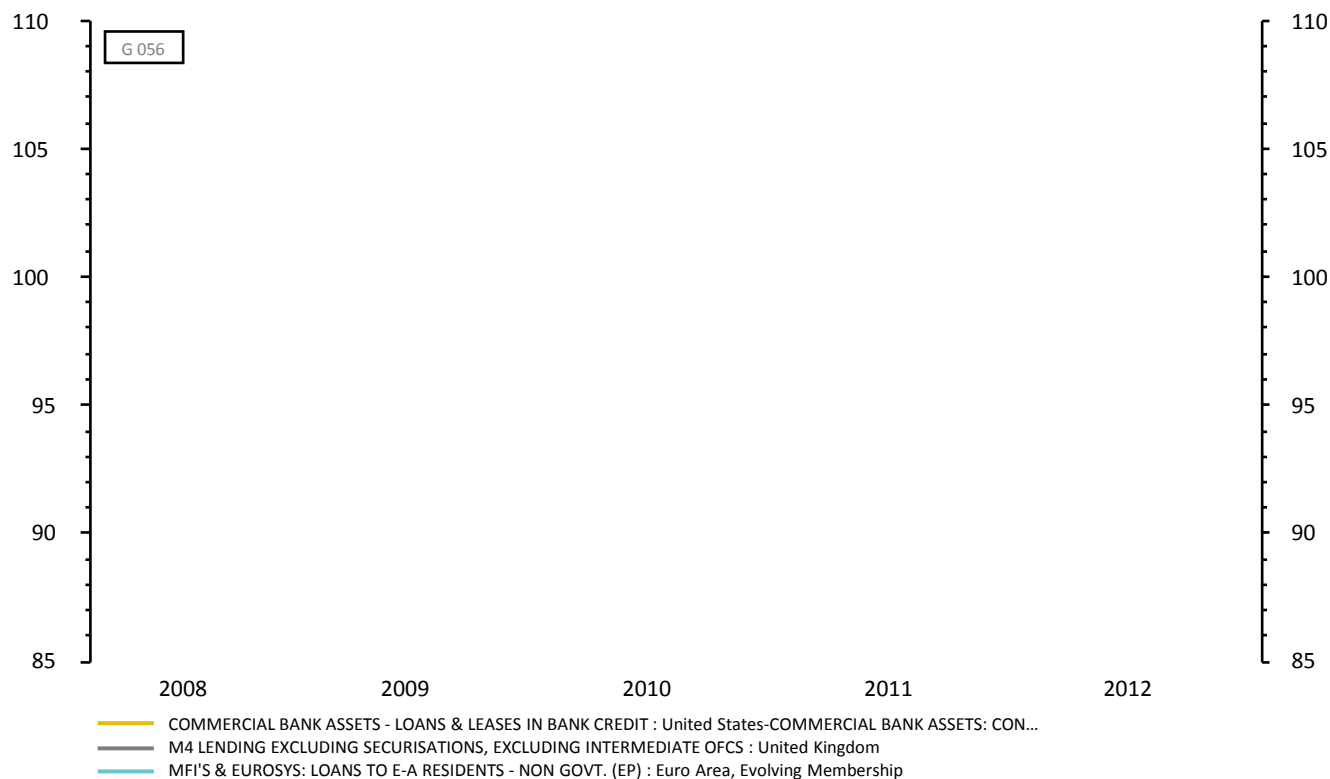
Source: Threadneedle, Reuters Ecowin, Reuters Ecowin October 2012





# US bank lending vs. European bank lending

...US and UK banks are 3 years into shrinking their balance sheets. European banks not yet started necessary deleverage

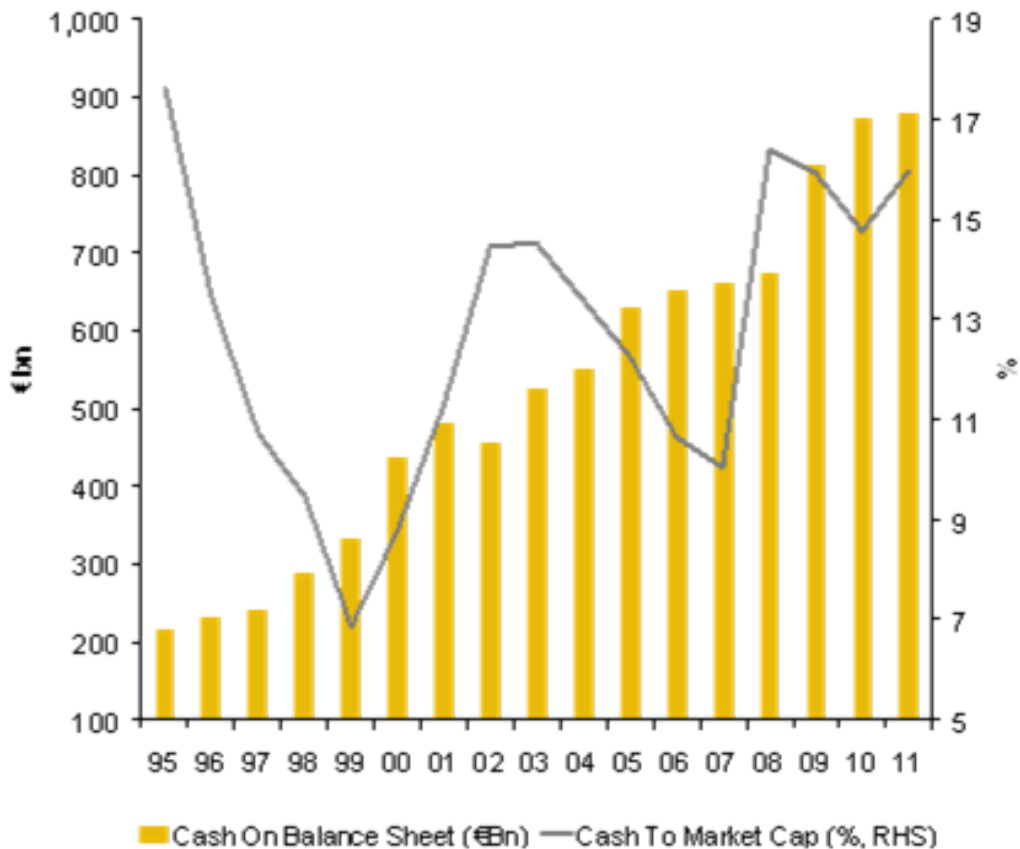


Euro area domestic bank loans (€11.2trn) + external loans and sec's (€5.3trn) have yet to contract; but loan-to-deposit gap is a wide 126%

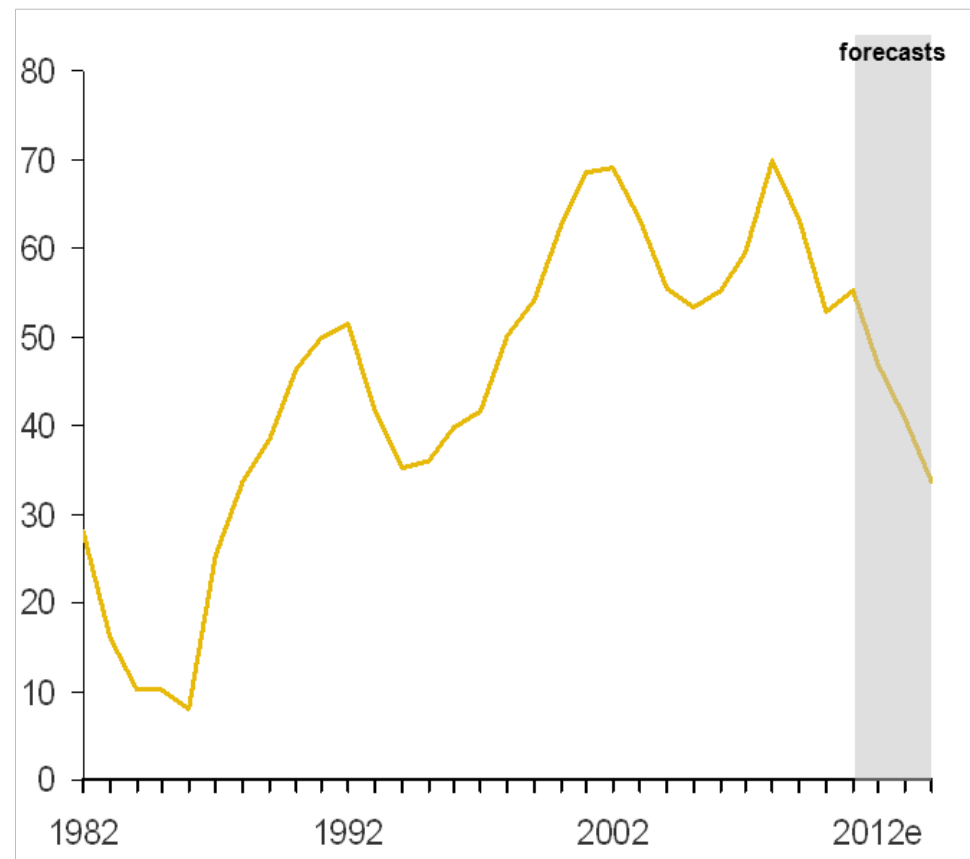
Source: Thomson Reuters Datastream, Arbutnot, October 2012.

# Corporate balance sheets are strong – excluding financials!

## Cash on balance sheets



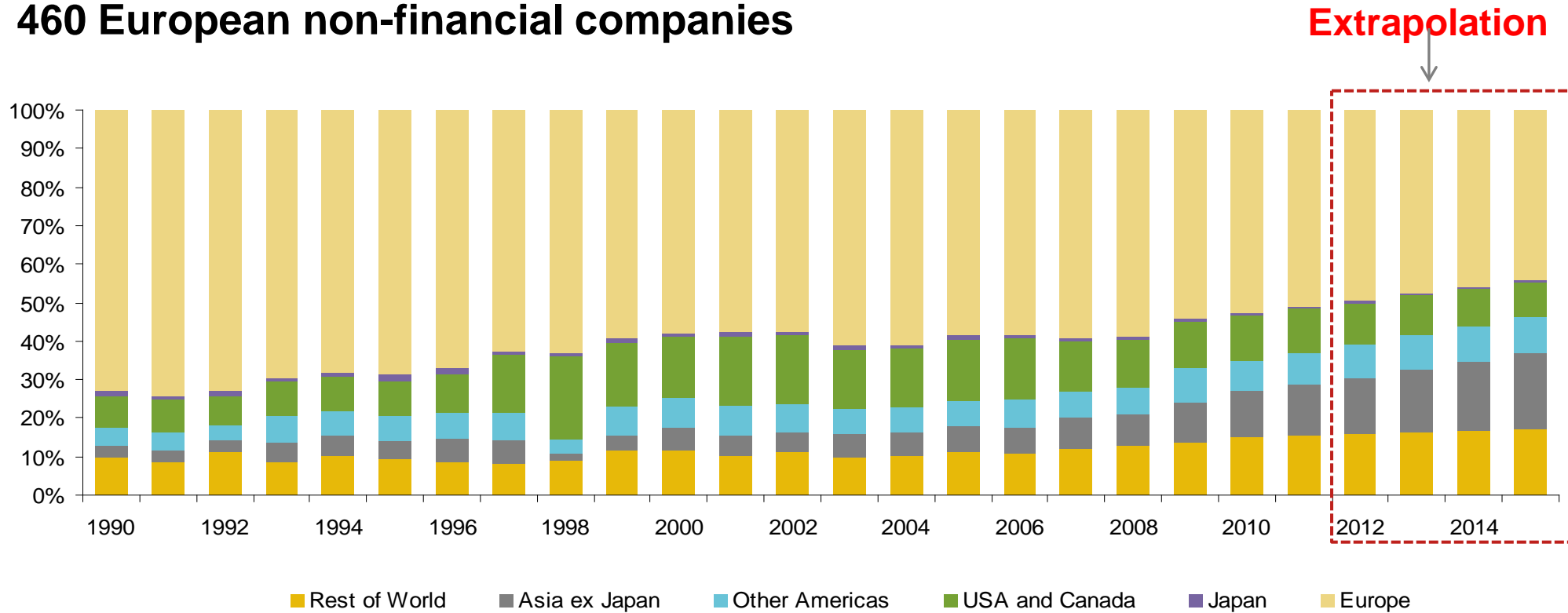
## Ex-financials debt to equity (%)



Source: MSCI, Worldscope, Morgan Stanley Research, 31 December 2012.  
All data above based on companies within the MSCI Europe ex-Financials.

# European companies sales are increasingly global

## 460 European non-financial companies

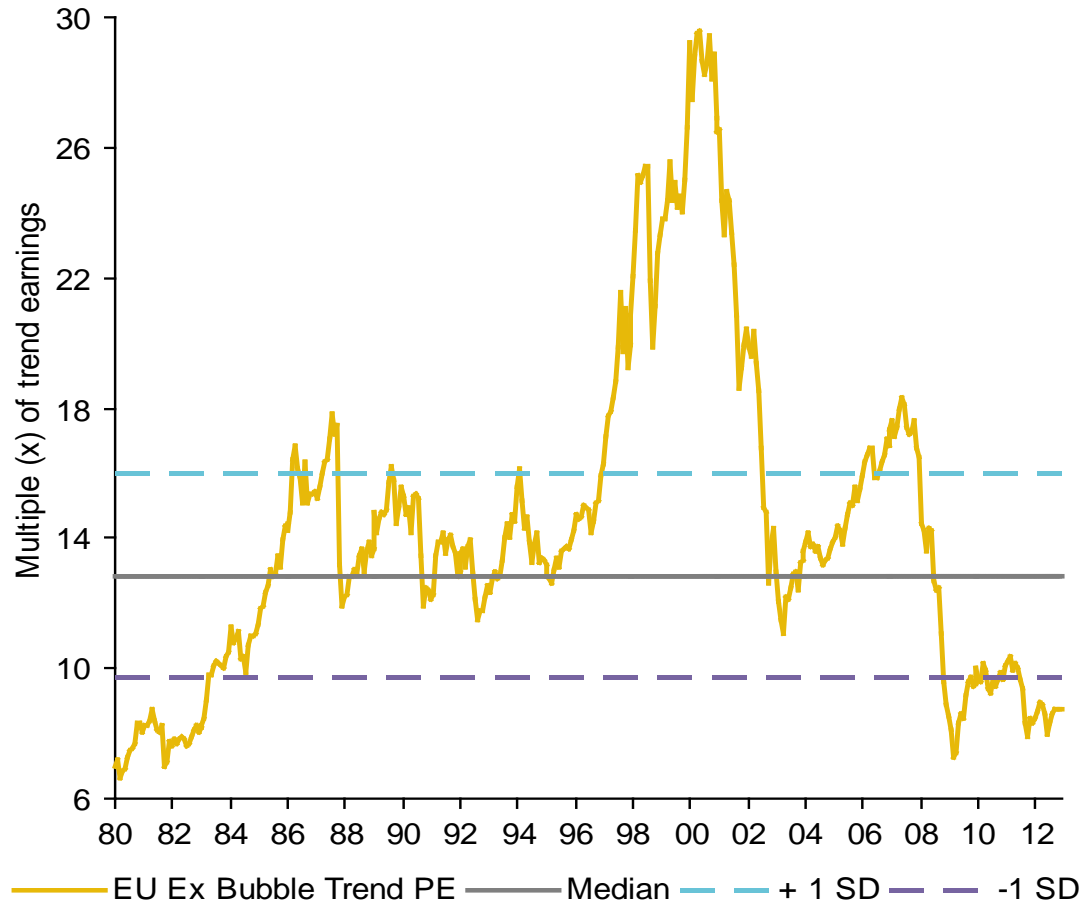


European equities are a play on global growth

Source: Published accounts/Redburn IDEAS database.

# What next?

## Equities are cheap<sup>1</sup>



- Volatility to continue
- Remain alive to macro developments
- Many alpha opportunities
- A stock picker's paradise

<sup>1</sup> Source: Mirabaud Securities LLP, 30 November 2012.

# The case for European equities

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	Index Level	2013E PE	2014E PE	PCF	2012 yield (%)
US - S&P 500	1,466	14.4	13.8	8.4	1.9
<b>Europe – MSCI Europe</b>	<b>99</b>	<b>13.6</b>	<b>12.4</b>	<b>7.5</b>	<b>3.3</b>
Japan – TOPIX	889	17.8	13.2	5.3	3.2
Asia Pacific ex. Japan – MSCI Asia Pacific ex Japan	476	13.2	12.3	8.9	2.9

Source: Threadneedle Investments, Bloomberg, 4 January 2013

# Characteristics of companies we like

Themes	Portfolio strategy	Examples
<b>Strong franchises / unique assets</b>	<ul style="list-style-type: none"><li>■ Market leaders</li><li>■ Strong finances / management</li><li>■ Barriers to entry</li></ul>	<ul style="list-style-type: none"><li>■ Nestlé, Ryanair, Fresenius Medical Care</li></ul>
<b>Restructuring / recovery</b>	<ul style="list-style-type: none"><li>■ New management strategy</li><li>■ Improving returns</li><li>■ Value creation</li></ul>	<ul style="list-style-type: none"><li>■ Allianz, Merck</li></ul>
<b>Quality cyclicals</b>	<ul style="list-style-type: none"><li>■ Growth potential</li><li>■ Overseas earnings</li><li>■ Strong finances</li></ul>	<ul style="list-style-type: none"><li>■ Sika, SGS, Lanxess</li></ul>
<b>Structural growth</b>	<ul style="list-style-type: none"><li>■ Demographic trends</li><li>■ Energy efficiency</li><li>■ Global shortages</li><li>■ Innovation</li></ul>	<ul style="list-style-type: none"><li>■ Syngenta, Atlas Copco, Novo Nordisk</li></ul>
<b>Emerging markets opportunities</b>	<ul style="list-style-type: none"><li>■ Emerging markets exposure</li><li>■ Reasonable valuations</li></ul>	<ul style="list-style-type: none"><li>■ Edenred, ABI</li></ul>

Source: Threadneedle as at 31 December 2012.

# Thanks!

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Please feel free to join the workshop session this afternoon to further discuss the European Equities opportunity:

- Time: 2:45pm
- Location: Granville Room

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