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**EUROPEAN EQUITIES – STOCKS THAT SHINE AMID THE EUROZONE GLOOM  
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**The eurozone's travails are the latest in a long line of crises to afflict Europe. Admittedly the eurozone's current difficulties pose a particularly challenging problem, but just as during previous periods of economic or political turmoil, many European companies continue to prosper and to offer potentially excellent rewards for long-term investors.**

Europe's economic outlook is deteriorating – the eurozone may already be in recession – and uncertainty over whether political leaders have the will or the ability to rescue the euro are now exacerbating the economic downturn. The arrival of technocratic leaders in Athens and Rome was supposed to be a positive development in terms of the euro's prospects. But recent events suggest that the political environment in both countries remains volatile.

In Greece, the new technocratic government must approve a fresh bailout package and commit to reforms in order to secure the next instalment of an international loan. However, two party leaders within the coalition remain reluctant to sign a document committing themselves to the bailout terms. In Italy, a technocratic administration, led by the newly-appointed Italian Prime Minister Mario Monti, has taken power. However, the right-wing Northern League says it will "relish" opposition and former Prime Minister Silvio Berlusconi has reportedly warned that he could withdraw support if the government follows policies that he does not favour.

Thus markets fear that both countries could see political instability that will precipitate elections, the outcome of which will be uncertain. Governments committed to further austerity drives and euro membership could win power, but it is also possible that parties that advocate leaving the eurozone will gain in popularity. Consequently, investors are concerned that the probability of the euro's collapse is increasing.

**Political leaders take Europe to the brink?**

Meanwhile, Europe's political leaders may be playing a dangerous game of brinkmanship to boost their bargaining power – in the case of Germany so that it can enforce further austerity on peripheral members. Or perhaps they are simply unwilling to take the action needed to save the euro.

Such reluctance could be understandable given that as the euro crisis has developed, it has become increasingly expensive and difficult to solve. The 'policy' so far has been to pursue austerity and reform, most severely in the periphery. Some countries have been quicker and more successful in adopting such measures – Ireland and Spain – whilst others have lagged – Greece, Italy and France. Following the November general election in Spain, voters in Greece and even Italy may go to the polls in the coming months, while the French presidential election will follow in May.

These elections will provide voters with the opportunity to choose an alternative. While the Spanish have opted for further and deeper austerity and reform, it remains to be seen whether other countries will follow their lead. However, there is a need for countries and institutions which can help growth

(Germany and the ECB) to show willing. Otherwise, the euro is likely to plod inexorably towards the abyss – muddling through is no longer sufficient. It remains to be seen how far Europe’s leaders will go to protect the euro.

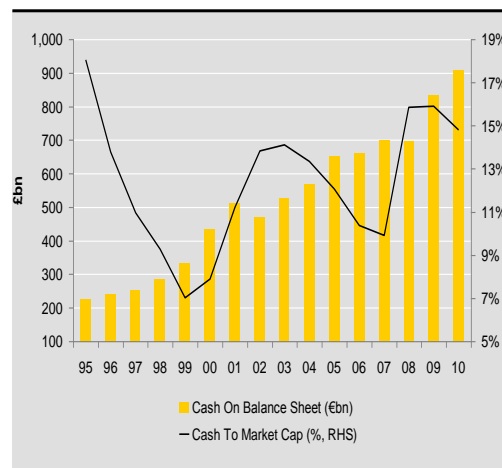
### Weak euro boosts exporters

Despite the eurozone’s woes, we continue to find good companies on attractive valuations. Exporters, for example, are benefiting from the euro’s weakness and, given the turmoil on European financial markets, their competitiveness could increase further. Furthermore, while the eurozone may already been in recession, Asia is still growing and we have recently seen some better than expected news out of the USA. While 2012 could well prove a difficult year for the eurozone, we are unlikely to see as sharp a downturn as took place in 2009 when the eurozone contracted by over 4%.

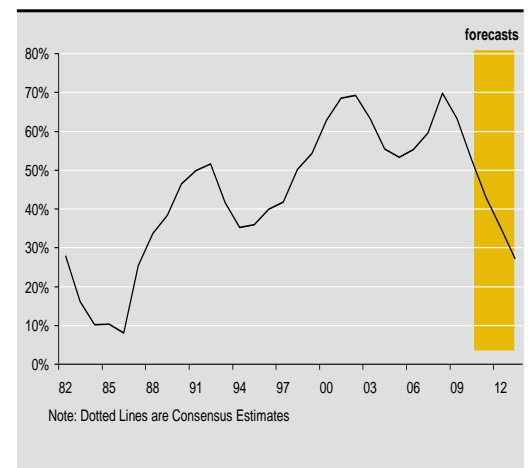
In addition, while the financial sector - and in particular banks - are weighed down by weak balance sheets, the opposite is true of much of the rest of the corporate sector. There are certainly a large number of attractively-valued European companies with robust finances that are well placed to survive a significant economic downturn let alone zero growth in Europe. Moreover, those companies that do have strong finances can borrow money at very low costs. However, given the uncertain outlook, businesses are reluctant to do so.

### Corporate balance sheets are strong – excluding financials

Cash on balance sheets



Ex-financials debt to equity (%)



Source: MSCI, Worldscope, Morgan Stanley Research, 31 August 2011. All data above based on companies within the MSCI Europe ex-Financials

### Businesses that continue to prosper

DnB, Norway's top lender and one of Scandinavia's leading banks, is an example of the type of company that we favour. It currently trades on a PE of around 7.5 times 2012 earnings and yields around 7%, yet is not significantly affected by the eurozone crisis.

Ryanair also has considerable investment appeal. The budget airline has pricing power and, although it is not growing as fast as it once did, it has a large cash pile and is trading at just 12 times next year's earnings. In November, the company posted a 20% rise in profits. Europe's largest short-haul carrier also raised full-year profit guidance and its chief executive Michael O'Leary said that the eurozone crisis appeared to have benefited his business by making customers more price-sensitive.

In terms of exporters, Swatch, the world's largest watchmaker, is benefiting from rapid sales growth in Asia generally and in China in particular. Demand for watches has soared in Asia — a region that accounted for more than half of

Swiss watch exports last year. The stock is trading at 14 times 2012 earnings but has cash on the balance sheet.

The German vehicle maker Daimler holds a higher risk/reward potential. The stock trades on 6.2 times 2012 earnings and offers a dividend yield of 6.2%. Of course, if the eurozone plunges into a significant recession the earnings figures are likely to be downgraded sharply and the dividend may not be paid. However, the share price could also rise sharply if economic conditions improve.

### **Conclusion**

In conclusion, the eurozone crisis has undoubtedly cast a pall over Europe's short-term economic prospects and depressed stock prices. But many of Europe's companies are either global in nature or powered by domestic markets or sectors that are relatively unaffected by the macro developments. Investors prepared to look beyond the headlines and adopt a long-term approach can even exploit the current crisis to buy shares in excellent businesses at very attractive prices.

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