

# Market Insights

## Europe: Monthly Review and Outlook

July 2014

- European equity markets were flat in June
- European Central Bank took measures to boost lending and growth
- In UK, the stock market fell, reflecting the general lack of volatility of share prices

### Review (covering June 2014)

- European equities were little changed in June, as geo-political uncertainties and a 'shy' global economic recovery still weighed on investors. In terms of markets, the oil and gas sector was the best performer in June, benefiting from a hike in energy prices following uncertainties in Eastern Europe and the Middle East. This was complemented by a positive performance for the healthcare and utilities sectors, indicating a temporary return to defensive stocks by investors. Financials posted the worst performance during the month of June, especially pulled down by a Portuguese bank which dropped by 37.55% this month alone, on governance concerns, and triggering a management reshuffle.
- Expectations of Mario Draghi, President of the European Central Bank (ECB), acting in the face of a very low inflation rate in the Eurozone, materialised on 5 June, with the ECB introducing an unprecedented set of measures to tackle deflationary risks and spark demand: the Main Financing Rate set by the ECB was decreased from 0.25% to 0.15%, and the Deposit Facility Rate was placed into negative territory at (-0.1%), compelling banks to make loans or pay charges on any additional capital placed at the central bank on top of their minimum requirements.
- New facilities made available through the 'Targeted Longer-Term Refinancing Operations' or TLTROs provided banks with new attractive borrowing terms, and even further incentive to lend. While ECB measures were widely seen as positive stimuli and a step in the right direction, they were relatively outweighed by June macroeconomic data coming out of Europe and the US, which still showed mixed economic signals. The Eurozone economic confidence indicator dropped to 102 from 102.7 in the previous month, missing the expected 103 level. There was also a drop in the consumer and industrial confidence indicators compared to the May levels, impacted by the on-going crisis in Ukraine, developments in Iraq, and the US quarterly gross domestic product (GDP) numbers, which shrank more than forecast and posted the worse reading since Q1 2009.
- In the UK, the FTSE All-Share index fell, continuing to reflect the general lack of volatility of share prices. Despite this lacklustre trend the economic news in the UK has continued to improve and perhaps reflecting this steady improvement there have been some consequent comments from the Bank of England. In June the figures for employment for the three months ending April were released and this showed a very large rise of 345,000 which was the biggest increase in any three-month period since records began in 1971. This rise in employment took the latest unemployment rate to 6.6% from 6.8% previously. Despite this, the three-month average of earnings (including bonuses) fell to 0.9% in April versus 1.9% in March.
- The figure for consumer price index (CPI) inflation for May was then released which showed a fall to 1.5% from 1.8% in April. Such positive data may have helped to keep the volume of retail sales at an elevated level. It was in the context of such economic reports that the Governor of the Bank of England made his annual speech at The Mansion House. In this speech, when considering the outlook for interest rates, Mark Carney said that the exact timing of the first rate hike was becoming more balanced and that 'it could happen sooner than markets currently expect.'

***“Views of our  
European Equity  
team based in  
Henley-on-Thames”***

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#### Market outlook

- We continue to believe many of the headwinds facing Europe are starting to fade: the economy, in our view, is set to grow again this year, accommodative monetary policy should continue and credit demand is starting to show signs of improvement. This should be supportive for corporate earnings with foreign exchange strength expected to be less of an issue as we move through the rest of 2014. In particular some of the more cyclically exposed sectors should benefit from an improving macro environment, for example, the media sector.
- In Europe, earnings growth or the lack of it in the last few years has been a key concern for the stock market but we remain confident that this should resume in due course as earnings recover from very depressed levels. A gradual improvement in economic activity should also encourage investors to re-appraise some of the sectors more impacted by the Euro crisis, for example, banks/insurance as opposed to being exposed to the more defensive areas such as consumer staples, where we find the risk/reward profile far less compelling.
- In the UK, the market faces a number of headwinds in the remainder of the year. Reducing levels of central bank stimulus combined with higher valuations than we have seen for some time, suggests that we are unlikely to see a repeat of the kind of gains experienced in 2013. Additionally, we have continued to see attrition in earnings estimates (in fact downgrades have out-numbered upgrades from much of the last 2 years), although this has been predominantly been due to foreign exchange headwinds, rather than underlying trading, over the last few months.
- The previously buoyant IPO market of the UK market, which saw some terrific first day premiums in Q1 2014, is showing significant signs of investor fatigue. Many of the recent deals are now trading at a discount to the issue price. This should lead to more realistic pricing going forward, which will hopefully allow us to buy some good companies at reasonable prices.
- The UK's economic backdrop continues to improve, with the recent pick up in business investment being particularly encouraging. We continue to believe that government and central bank policy in the UK will remain broadly expansionary ahead of the general election next year. This ought to bode well for the domestically focused names. With the economy on a sounder footing, there is also the potential for the return of mergers and acquisitions activity. So despite some headwinds, we remain optimistic about further positive returns in the coming year.

European equities (as at 30 June 2014)					
	1 Month	3 Months	6 Months	YTD	2013
FTSE World Europe ex-UK (£)	-2.3%	0.1%	3.1%	3.1%	25.2%
MSCI Europe	-0.4%	4.3%	6.6%	6.6%	20.5%
France: CAC 40	-1.7%	3.2%	5.7%	5.7%	22.2%
Germany: DAX	-1.1%	2.9%	2.9%	2.9%	25.5%
Spain: Ibex 35	1.5%	6.7%	12.3%	12.3%	30.0%
Italy: FTSE MIB	-1.2%	0.1%	14.5%	14.5%	20.5%
Swiss Market Index (capital returns)	-1.4%	1.2%	4.3%	4.3%	20.2%
Amsterdam Exchanges	1.5%	4.1%	4.8%	4.8%	20.7%
HSBC European Smaller Cos ex-UK	-0.6%	1.3%	10.7%	10.7%	34.0%
MSCI Russia (US\$)	5.5%	10.8%	-5.2%	-5.2%	1.4%
UK: FTSE All-Share	-1.3%	2.2%	1.6%	1.6%	20.8%
UK: FTSE Small Cap ex Investment Trusts	-1.3%	-1.6%	0.4%	0.4%	43.9%

Source: Thomson Reuters Datastream, total returns in local currency unless otherwise stated.  
Data as at 30 June 2014.

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