

## Market Insights

### Europe: Monthly Review and Outlook

June 2014

- ECB president Mario Draghi expected to deliver easing measures
- European macroeconomic data remained robust
- UK consumer confidence rose

#### Review (covering May 2014)

- European equity markets moved higher in May despite a weaker-than-expected GDP growth number and fairly muted Q1 corporate earnings results. The strength of the Euro has been a headwind for earnings recovery, and any reversal in the coming months would be beneficial. Expectation has been mounting that European Central Bank (ECB) president Mario Draghi is set to act on 5 June. Likely on the agenda will be a range of easing measures, from interest rate cuts to possible new long-term refinancing operations for banks and Asset Backed Security purchases. What is likely to be seen as the key positive though is that the ECB is expected to keep the door open to greater Quantitative Easing for some point later in the year.
- The ECB bank lending survey (released in early May) showed that credit demand has picked up for all loan categories in the first quarter of 2014. As Europe's economy is typically bank-funded, seeing an improving trend in credit demand is a helpful development for the economy and for corporates generally. The positive numbers are still small, but in a region of the world that has become used to negative data from its banking sector for a long time, positive numbers of any sort is major news. The detail is interesting: the pick-up in demand for credit saw positive contributions from credit for M&A and inventory financing, whilst the survey also showed an improving trend in funding for capital expenditure.
- Elsewhere in macroeconomic news, the eurozone composite Purchasing Managers Index (PMI) edged down to 53.9 in May, from a near three-year high of 54.0 in April. Although the services PMI rose to a 35-month high of 53.5, this was offset by a slower pace of growth in the manufacturing sector in May. The country PMIs reinforced the picture of continued divergence between the eurozone's two largest economies. The German composite PMI was unchanged at 56.1 in May. Meanwhile, the French PMI dropped to a 3-month low of 49.3, from 50.6 in April, suggesting another poor quarter for the French economy.
- The small rise in the FTSE All-Share index in May built on the rise of previous month, keeping therefore within the recent range of modest changes it has had for a few months. April's initial report for Q1 GDP was left unchanged in May as were estimates for previous quarters. This meant that growth for Q1 was 3.1% year on year and that total output for the economy has now recovered to a level just below its pre-recession peak from Q1 2008. Within the make-up of the UK economic growth the biggest positive surprise was the 2.7% quarterly increase in business investment. This confirmed a useful trend as it was the fifth consecutive meaningful quarterly rise.
- An analysis of the month's larger sector price movements from within the UK equity market showed that health care equipment and fixed line telecommunication were amongst the better performers whereas mobile telecommunication and oil equipment services were amongst the worst.

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

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#### Market outlook

- With modest economic growth as our expectation, and corporate earnings growth likely to recover in 2014, we believe European equity markets are attractively valued, with big disparities in existence both in terms of countries and sectors. On a cyclically adjusted Price Earnings basis, we're looking at very depressed valuations against the long run average in countries like Spain, Italy and France, while on a sector level, the outliers at the two extremes are consumer staples, which by and large look very expensive, and financials, which look good value in our opinion.
- We also believe that we have still not seen the end of the market's move away from expensive perceived 'safe haven' style stocks (e.g. consumer staples) towards more attractively valued stocks linked to the improving dynamics of the financial sector, economic recovery and restructuring.
- Despite seeing gains in European (ex UK) smaller companies markets during 2013, we see the potential for earnings upgrades to now come through over the next 12 months amid an improving macroeconomic backdrop. We believe market volatility will continue to create opportunities for us to add to our holdings in companies which we consider to be market leaders in their fields, or which enjoy niche status, and are capable of delivering higher returns on capital than GDP growth.
- We continue to look but not overpay for companies which we believe have good growth potential. Our preference is for companies which we believe can grow their earnings irrespective of the broader macroeconomic environment, as well as those where we believe their share prices do not reflect their fundamental value.
- Over the last two years the UK equity market has made a considerable recovery, which we believe has allowed valuations to move closer to fair value. Despite this we believe that corporate earnings can grow from here, albeit at a more modest pace.

#### European equities (as at 31 May 2014)

	1 Month	3 Months	6 Months	YTD	2013
FTSE World Europe ex-UK (£)	2.0%	3.3%	6.2%	5.6%	25.2%
MSCI Europe	2.7%	4.0%	8.2%	7.1%	20.5%
France: CAC 40	2.3%	4.7%	7.8%	7.5%	22.2%
Germany: DAX	3.5%	2.6%	5.7%	4.1%	25.5%
Spain: Ibex 35	3.6%	7.8%	13.0%	10.7%	30.0%
Italy: FTSE MIB	0.8%	7.5%	15.6%	15.9%	20.5%
Swiss Market Index (capital returns)	2.3%	2.4%	5.0%	5.8%	20.2%
Amsterdam Exchanges	2.8%	3.9%	4.7%	3.3%	20.7%
HSBC European Smaller Cos ex-UK	2.3%	3.1%	12.8%	11.3%	34.0%
UK: FTSE All-Share	1.4%	0.9%	4.8%	2.9%	20.8%
UK: FTSE Small Cap ex Investment Trusts	-0.7%	-4.3%	5.5%	1.7%	43.9%

Source: Thomson Reuters Datastream, total returns in local currency unless otherwise stated.

Data as at 31 May 2014.

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