

Global Equities – September 2013



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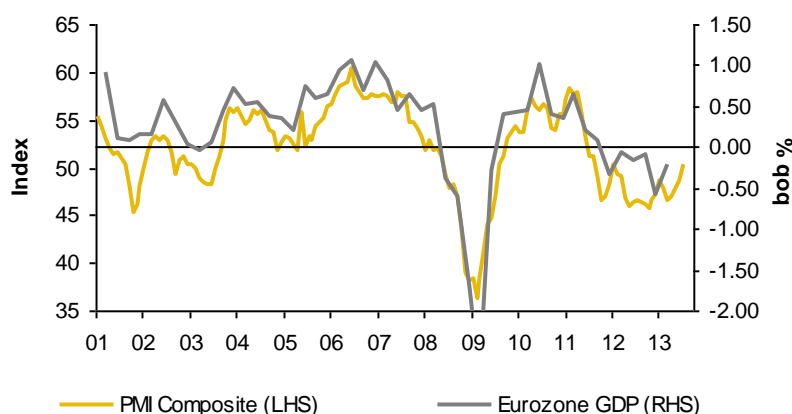
The global economy is finally stabilising as the recovery in the US spreads to the rest of the developed world.

As summer fades and an autumnal chill enters the air in the northern hemisphere, the developing world appears to be emerging from the long economic winter that followed the global financial crisis of 2008. In this viewpoint, William Davies surveys the global economy and highlights those stocks and sectors we favour.

While the US economic recovery has been a feature of financial markets this year, it is only recently that signs of improvement have become established in other developing economies. According to figures released in August, the eurozone emerged from recession in the second quarter of 2013 after a record 18 months of economic contraction. The good news has continued – August orders for goods made in the eurozone, for example, came in at their fastest rate since May 2011.

Figure 1: European economic indicators are improving

Euro PMI composite vs. GDP (QoQ)



Source: Threadneedle, Bloomberg, June 2013.

Europe, over the worst?

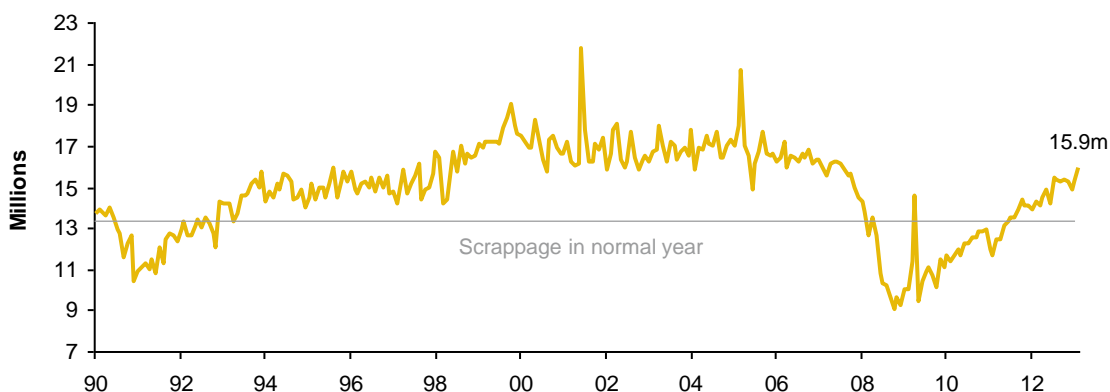
Our base case for Europe remains a slow and protracted economic recovery. However, we believe the worst is now over and are taking advantage of relatively attractive valuations. We continue to avoid stocks in the periphery, and heavily indebted businesses, which are at risk should negative growth shocks emerge.

We have recently taken positions in the Swiss bank UBS and Continental, a leading German autoparts supplier. UBS has been making progress downsizing its investment banking operations, where it has lacked the scale to compete effectively. The bank is strengthening its capital position and focusing on wealth management, an area where it is a global leader – boasting a relationship with half the world's billionaires.

Continental is benefiting from a strengthening global automotive industry, and rising auto sales. Even in austerity-hit Europe there are grounds for optimism. Car sales in Germany, France and Spain rose in July. Sales of premium cars, many of which are equipped with Continental's safety features, have rebounded in the US, and a growing Chinese appetite for luxury brands provides further support.

Figure 2: US auto sales are growing strongly

US auto sales SAAR



Source: Bloomberg, as at 30 June 2013.

Weaker yen boosting Japanese profits

We are optimistic about the efforts of Japan's Prime Minister, Shinzo Abe, to revive the economy. His policies, known as 'Abenomics', include boosting the supply of money in the economy and increasing government spending. Abenomics has already had a dramatic impact, sending the stockmarket soaring, whilst Japanese firms have reported a surge in profits largely thanks to the weakening yen. In early August, for example, Toyota raised its annual profits forecast and is expected to nearly double its profitability in the 12 months to March 2014, versus a year earlier. Critically, Japanese consumer prices have started to rise, a sign that the policies aimed at ending deflation are yielding results. Consumer price inflation rose to an annual rate of 0.7% cent in July, its highest level in almost five years.

We have been overweight Japan since early this year. Initially focused on exporters who are the immediate beneficiaries of a weaker yen, we have since broadened our exposure, taking positions in a number of domestic Japanese-exposed names, including the likes of Aeon, one of the largest diversified retailers in Japan. A return to inflation would be supportive of depressed margins for the company, and management is also considering spinning off property holdings into a REIT, which would generate significant cash flow for shareholders. We have invested in domestic Japanese banks, including Sumitomo Mitsui Trust and Nomura. The latter is a global investment bank, leveraged to a recovery in Japanese M&A and financial market trading volumes.

Tapering talk signals the beginning of the end of the financial crisis

Our longstanding overweight positioning in the US has been rewarded in 2013. The housing led-economic recovery is now much more firmly established than in the rest of the world. Indeed, while markets have recently been concerned that any tapering of quantitative easing (QE) could have a negative impact on financial markets, we take a longer term view and regard the increasing momentum that is prompting discussion of tapering as a positive development. We welcome the return to normality following the adoption of unconventional monetary policies to deal with the effects of the global financial crisis.

Our positioning favours cyclical sectors, in particular, companies exposed to the shale energy revolution and to rising consumer spending. We see potential in beneficiaries of the growing e-commerce sector, such as eBay, and in companies providing non-cash payment solutions including credit card companies such as American Express, Mastercard and Discover.

Stock-picking offers value in emerging markets

Emerging markets have come under considerable pressure recently following the change in direction of US monetary policy. Those emerging economies reliant on foreign capital inflows to fund their current-account deficits have been particularly affected. Valuations appear increasingly attractive, and emerging economies in general are much better placed than they were during earlier cycles of monetary tightening, such as in 1994. Although we remain concerned about countries with large current-account deficits, such as India and Indonesia, we are more confident in those economies that are in a balanced or surplus current-account position. We believe that the differentiation in performance between countries/sectors in emerging markets will continue and prefer export-oriented economies such as Thailand and Mexico, at this stage in the cycle, as they should benefit from the consumer recovery in the developed world.

Technology and consumer discretionary sectors appeal

Turning to the sectors that we favour globally, we remain overweight consumer discretionary and technology stocks. We think the former offers good growth potential, while the latter trades on undemanding valuations with management under increasing pressure to reward shareholders through share buybacks and dividends.

We own Priceline.com, a travel comparison website. The company's flagship website booking.com continues to expand as consumers turn to the internet to book accommodation. Further intergration with Kayak, a popular flight comparison website, has seen booking.com win market share from its largest online travel agent competitor Expedia.

Samsung remains one of our favoured technology companies. It has underperformed this year as the market fears margins for the key mobile division will decline. We like the company's increasingly dominant position in the smart phone and wider technology industry, and see competitors falling by the wayside. We believe the market is pricing in an overly severe deterioration in margins, and that, at the current low valuation, the stock is attractive.

Outlook

We are concerned that any deterioration in the eurozone could once again harm global investor sentiment. There is a suspicion that potential problems in the eurozone may have been deferred until after the general election in Germany in September. The German public appears to be increasingly weary of being asked to bail-out troubled peripheral countries. Another concern is that a slowdown in the emerging economies impacts companies such as Nestle, which have been profiting from the rise of the emerging consumer.

Overall, we anticipate that global equities will encounter volatility in the final quarter of the year as investors weigh the likelihood and timing of QE tapering. The speed and scale of its implementation will be critical. However, we remain positive on the outlook for global equities given the strong underlying fundamentals in the form of increasing economic growth in the developed world. Moreover, we believe that concern over the impact of tapering may have been exaggerated, believing that it signals a return to normal conditions.

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