Investment Insight

Friday, 11 August 2017

ARIA | CAPITAL

Once bitten, twice shy*: For several years, European equity analysts over-estimated the earnings growth potential of European companies. So much so that this year, as we observe the investment tide turning in favour of European equities, they were probably too cautious.*

Europe's perceived political risks have abated for the moment. The election of president Macron in May and the commanding parliamentary majority he won in June seemed to signal a lurch back from the political extremes that had garnered popular support for some time previously. Consequently, our attention turns particularly to investment managers who are well positioned to exploit the shifting European trend. Artemis' Paul Casson is one such and in this week's ***Inside Track*** *we look at how he currently reads the market.*

Less is less*: Does it ever feel like you're getting through your snacks or convenience meals faster than you used to? Well, maybe you are, but it's probably because they're shrinking, not because you're eating faster!*

A recent UK study showed that shrinking portion sizes among food manufacturers is quite common, although many won't have even noticed it. Prices, as you might expect, haven't been following falling proportionately. In fact the trend has been seen in products as diverse as coffee and toilet paper. The phenomenon even has a name: shrinkflation! In this week's ***Pic of the Week*** *we take a look.*

Quoted...

"There's been a load of compromising, on the road to my horizon, but I'm gonna be where the lights are shining on me." – Glen Campbell, RIP

The Inside Track

Paul Casson, who has managed the Artemis Pan-European Absolute Return fund since its launch in July 2014, has shown himself to be an astute observer of markets and of investor behaviour. The following are some of Paul's recent views on the current state of the European investment universe.

Globally, economic data point to an acceleration in activity. The threat of inflation has replaced that of deflation. Central bankers recognise this change: the US Federal Reserve has begun to raise interest rates and the European Central Bank will follow in time. Wages across Europe are rising. Generally speaking, when people get paid more and are feeling more confident, they spend more. We expect this to happen in the larger economies: Germany, the Netherlands and France. Meanwhile, for the peripheral countries still recovering from sharp recessions, the change is about more people having jobs – and any wage growth at all here is an additional and welcome boost. This virtuous circle is the means by which GDP growth accelerates when demand rises. Bank lending follows – something we can already see happening.

After years of being too optimistic about European companies, analysts were too cautious at the start of this year and have raised their earnings forecasts since the New Year. This is a clear and a positive change. For the first time in many years, it is upgrades from cyclical stocks that are leading the way, with (expensive) defensives being left behind.

We believe the winners of the past nine years – 'quality growth', 'bond proxies' or 'expensive defensives' – are set for a much tougher period. Instead, we continue to expect to see a period of outperformance from the value component of European markets. Unlike the winners of the last nine years – the expensive defensives – cyclical companies have learned to survive on a thin diet. They responded by cutting costs, restructuring and becoming more efficient. When economic activity and sales pick up, this pays off in the form of improved operational leverage, meaning they keep a disproportionate part of every additional euro of revenue as profit.

Our long positions tend to be concentrated in banks, industrials, energy stocks, materials and consumer cyclical businesses. These are the areas with the most to gain from the improving outlook. Conversely, our short-book is focused on beverages, utilities, healthcare and other expensive areas prone to disappointment.

Pic of the Week

Recent research suggests that "shrinkflation" has accelerated in the UK since Brexit. However, it's nothing new. Sentimental chocoholics amongst you will recognise the phenomenon depicted below. Ah well, maybe it's as well for the beach bodies!

Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	+0.0%	+14.0%	+10.0%	+9.9%
US equities	-0.1%	+13.4%	+9.7%	+11.8%
European equities	+0.3%	+10.5%	+4.7%	+6.6%
EM equities	+0.8%	+19.9%	+24.0%	+1.8%
Irish equities	-0.4%	+10.8%	+1.5%	+15.4%
Commodities	+0.3%	-5.4%	-3.3%	-10.0%
Hedge funds	+0.0%	+5.2%	+3.4%	+1.9%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.7%	-0.2%	+6.1%
Germany	+0.4%	+1.7%	+1.7%
USA	+2.2%	+1.6%	+2.1%
China	+3.6%	+1.4%	+6.9%

Week ahead: Key events

11/08 US CPI
11/08 Spain harmonised CPI
14/08 Irish consumer confidence index
14/08 Japanese June consumption
14/08 Irish construction PMI
14/08 China retail sales

Currencies	*Current*	*YTD Δ*
EUR:USD	1.18	+11.8%
EUR:GBP	0.91	+6.1%
EUR:CNY	7.81	+6.5%
GBP:USD	1.30	+5.2%
Bitcoin	3,435.25	+260.8%

Commodities	*Current*	*YTD Δ*
Gold	1,286.21	+11.6%
Copper	6,426.75	+16.4%
Oil	52.78	-10.3%
Wheat	485.50	+4.4%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

66 Fitzwilliam Square
Dublin 2
D02 AT27
Ireland

T: (+353 1) 685 4100
E: research@aria-capital.ie
W: www.aria-capital.ie

UNDIVIDED ATTENTION