WALTER SCOTT

BNY MELLON | INVESTMENT MANAGEMENT

FOR USE BY INSTITUTIONAL INVESTORS ONLY. NOT FOR USE WITH THE GENERAL PUBLIC.

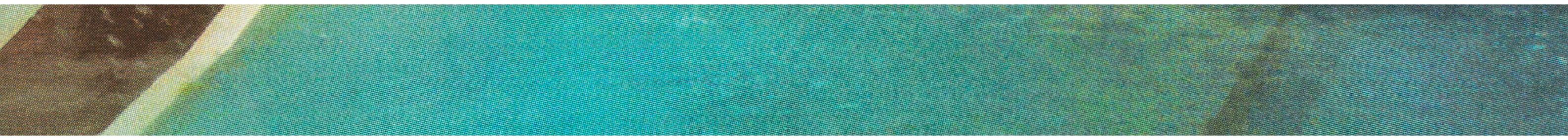
EURO-WOBBLES

FIRST PUBLISHED NOVEMBER 2022

"HISTORY IS JUST ONE DAMN THING AFTER ANOTHER"

This quip, debatably attributed to British historian A.J. Toynbee, might resonate with casual observers of the economic history of Europe since the Global Financial Crisis. The region has appeared to have had its fair share of economic volatility since that 2007/8 maelstrom, which saw European banks, as elsewhere, require state-sponsored intensive care. The European Debt Crisis followed in short order and tested the mettle of European Union unity. And just when the region was hauling itself robustly out of the Covid-19 pandemic mire, high inflation, exacerbated by the Russian invasion of Ukraine, subsequent gas supply issues, and rising interest rates have raised expectations that recession is imminent in much of the region.

ROY LECKIE
Executive Director – Investment & Client Service



NOT ALL BAD NEWS

However, several factors may limit a downturn - necessity has largely overcome Euro-dithering. Gas storage levels across Europe are running around 90%, thus diminishing supply rationing risks, and various support packages have been and continue to be put in place, aimed at reducing the impact of higher energy bills on consumers and companies. Natural gas and an array of commodity prices, even taking into account the strong US dollar, have retraced their gains significantly in euro terms, while an easing of supply chain issues was noted by the European Central Bank in its September Bulletin. However, these developments are partly due to weakening growth, and the gas supply situation remains volatile. Whatever the case, the inflation genie has not been put back in the bottle, and the bank is sticking to its tightening mantra for now.

Although many leading European companies have been showing operational resilience in the face of mounting challenges, the falls in the region's equity markets reflect a discounting of potentially weaker earnings ahead. For US investors in particular, European assets have certainly become cheaper given the strength of the mighty dollar.

AVOIDING GUESSWORK, AND STICKING TO THE FUNDAMENTALS

Whatever the economic climes, our research approach is not founded on macroeconomic guesswork, but on rigorous bottom-up analysis, focusing on the long-term growth prospects of quality companies.

We look for companies that enjoy market leadership and pricing power, with high operating margins that can mitigate cost headwinds, while financial strength allows their businesses to weather tougher conditions. Typically, they offer a product or service that endows them with a competitive advantage and a long growth runway that will endure beyond the periodic downturns that they may encounter over time. Many are geographically well diversified. Using a Walter Scott representative EAFE portfolio as an example, European-listed companies make up 57% of the portfolio, while overall portfolio exposure to Europe on a revenue basis is 22%*.

FERTILE HUNTING GROUND

And we believe Europe remains a great investor hunting ground for such companies. The pall of recession that hangs over the region should not tarnish the qualities of many leading European-listed stocks. Although Europe has had a penchant for economic underperformance, enterprise can exist even in the toughest of economic environments. Europe has long been a crucible for pharmaceutical companies with a history of innovation, such as Roche and Novo Nordisk. It is home to iconic luxury goods companies with brands and a heritage that are hard to replicate, such as LVMH and Hermès, as well as world-class, value-added industrial businesses such as KONE Corporation and dominant semiconductor lithography company ASML. Whatever the current travails of Europe, it is still a repository of great companies that should continue to excel on a global stage irrespective of their domicile.

*Source: Walter Scott, Factset. A representative Walter Scott international portfolio has been used to illustrate the point made. Data for the European revenue exposure derives from the reported sales breakdown from the most recently reported annual results of companies held as at the date the analysis was run (23rd September 2022).

WALTER SCOTT & PARTNERS LIMITED, ONE CHARLOTTE SQUARE, EDINBURGH EH2 4DR
TEL: +44 (0)131 225 1357 · FAX: +44 (0)131 225 7997
WWW.WALTERSCOTT.COM