Investment update

22 December 2011

Motoring ahead

The case for cars may not be obvious. But the opportunity for 2012 and beyond is less in home markets and mainly in faster growing emerging markets

Kevin Lilley, manager of the Old Mutual European Equity Fund

Kevin Lilley joined OMAM in October 2011 as a Europe ex UK equity manager. He was previously senior portfolio manager, European equities, at Royal London Asset Management, where his funds saw strong medium to long-term performance and he was AA-rated by CityWire. Prior to RLAM, he managed Continental European equities for TT International and NPI. Kevin is a Fellow of the Chartered Institute for Securities & Investment (FCSI).

No one can say that 2011 was uninteresting, though mostly for the wrong reasons. Looking ahead to 2012, investors are likely to be seeking opportunities which combine evidence of resilience and potential for growth. Some may be found in unusual places, others may be sitting right in front of us.

Having spent over 20 years managing European equity portfolios, I have always found it interesting to follow the automotives sector. Not only is this the second largest purchase most people ever make, it is also very important for its contribution to the overall economy, which is why western governments were so keen to introduce incentives during the 2008/09 recession.

I find that when analysing car companies and meeting the management, I get so much valuable information to help shape my overall economic and market view. These companies buy a lot of products from other sectors - metals, plastics, glass, fabric, machine tools, software, financial services and advertising space to name a few. It may only be a relatively small part of the benchmark, but its influence spreads much further.

The common misconception in recent years has been that this is a mature, ex-growth industry, with overcapacity, and as such should trade on low multiples. I accept that there may be overcapacity in volume car production, particularly where it is serving Southern Europe, but it is not the case globally. US capacity was significantly scaled back during 2008/09, when car-makers were forced into significant restructuring, before returning in a slimmed down shape. In the emerging world there has not been sufficient capacity to meet all demand, which is why western manufacturers are increasing production facilities in these areas.

When analysing the global car market, other than in 2009, we see that in recent years growth has been propelled by emerging markets. China now represents the largest car market in the world, having overtaken the US. Those companies supplying the right product in the right location have been making strong profit growth, regardless of sluggish markets in the developed world. Europe has an anticipated growth rate close to zero in 2012, but the US is gradually recovering and I see emerging market growth continuing to drive the sector forward. Rising incomes, low levels of ownership and a liking for quality western brands is likely to continue for many years.

This is important for me, running a Continental European equity portfolio, as Europe has some of the best run and most innovative car companies in the world, and some of the sector's strongest brands. Looking into 2012, some of the automotive companies we like include BMW, Michelin and Faurecia, the French component company. BMW supplies a more resilient western consumer base than the larger volume producers. In emerging markets it has a luxury status that, in my view, is not reflected in its

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valuation. Michelin supplies into global growth, leads in innovation and benefits from the growing aftermarket. Faurecia supplies almost all brands gloabally, on profitable long-term contracts.

Automotives may not seem obvious as a growth sector, but that may because we are not looking at it in the right way. Growth based on the developing world and innovation is here to stay.

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