Investment update

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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).

Life in Europe

It is easy to think, reading the news, that Europe is in a hopeless state. But there are some powerful opportunities if you look in the right places

Megacaps

European large cap stocks currently look very good value. In many cases, these are global rather than European businesses, with strong brands that can be sold into growing demand in emerging markets. Under a third of Nestlé's total sales, for example, originate in Western Europe, less than those coming from developing markets. In aggregate, European companies have around half of all sales coming from outside Europe. While providing exposure to higher growth regions, European mega caps offer the comfort of good corporate governance and transparent regulatory regimes.

Pharmaceuticals

The large pharmaceutical companies were de-rated as investors feared the impact of patent expiry and growing competition from lower cost generics. However, there are a number of examples of companies which have bought into growth through acquisition of higher tech businesses - Sanofi buying Genzyme, for example, or Roche buying Genentech. Sanofi has significant exposure to emerging markets, while cost savings are generating cash to pay down debt. These offer low valuations, high yield and now a return to growth.

Automotives

This is a variation on the mega cap theme. The focus is on businesses with strong finances and brands that can be sold into global demand. Mainstream volume manufacturers tend to be too exposed to declining demand in southern Europe as well as to the 'squeezed middle' in their home markets. Daimler has the core brand strength with Mercedes, of course, but it is also caught up in heavy vehicles and an unfunded pension. BMW is the preferred stock, as a 'pure play' - as a luxury brand it is relatively resilient at home and sought-after worldwide. It has strong cash generation and has a forecast dividend yield comfortably over 4%.

Quality

Companies that show consistent growth, with good yield and compelling business models - 'quality' stocks - will tend to outperform in the period leading up to the peak of the cycle. They are not defensive as such, but they are more resilient than highly operationally-geared cyclicals. A good example is SES Global, a Luxembourg satellite operator which has performed well through the market turmoil. It is the world's largest TV broadcast platform, hosting Sky, the BBC and ITV. Growth will come from emerging markets, new formats (such as HD) and military applications.

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