

# European equity markets to grow

Notwithstanding detailed analysis of investment fundamentals, the valuation of an individual equity is ultimately the price struck when buyer meets seller, as in any freely tradable market. However, when we value markets we must aggregate the impact of numerous variables on the market. We thus balance a range of diverse inputs, such as top-down macro-economic data, measurements of value and momentum, behavioural patterns among investors, the lessons of historical trends and a judgement of the opportunity cost of being invested in equities.

The last point is most regularly underlined by the relationship between bond yields and equity earnings yields, known as the BYEY. This tells us that today US equities are trading 30%, or two standard deviations, above their long-term average level as measured by this ratio. By contrast, the European equity market is around 15% cheap against a benchmark European bond yield on the same measurement.

Europe is not an investment island and if the US equity market were to

suffer a major setback, then the repercussions would be felt here too. However, we believe that three catalysts exist which could cause the relative cheapness of European equities against bonds to correct in the medium term. These are: growth, liquidity and earnings momentum.

## Growth

We are sitting at the bottom of the interest rate cycle in Europe at a time when monetary conditions are at their most stimulatory for nearly 20 years. In addition, the currency is competitive and fiscal policy is providing a boost to growth. Industrial surveys are improving and stronger consumer and construction activity is already showing up in EU surveys.

## Liquidity

In the US, the flow of retail money into domestic equity funds has been positive in nine of the last eleven weeks, despite a shaky end to 1998. However, the European picture is less well-defined. Negative inflows to domestic equity funds were recorded from December

1998 through to February 1999. In March, PEP purchases before the end of the UK fiscal year pushed that month's total into positive territory. Nonetheless, flows into international equity funds (which include European investors buying funds that invest in other European countries) saw net inflows in excess of \$6bn in March.

As the expected economic upturn gathers pace, we anticipate that retail confidence in the equity markets will grow, which should serve to boost inflows to mutual funds.

## Earnings momentum

The consensus of bottom-up analysts' forecasts suggests that euro-area corporate earnings will grow by 11% in 1999 and 16% in 2000. However, while US corporate earnings forecasts have been upgraded by 1.5% throughout the month of April, following the Q1 reporting season, European forecasts have yet to recover after the downgrades of early 1999.

Even though rising bond yields will certainly create a downdraught for equity valuations, we nevertheless anticipate an 8% upside in the European equity markets by year-end, with the realisation of our forecast resting on an upturn in growth through the second half of the year. ■

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## INTERNATIONAL EQUITIES

These are a selection of issues announced recently. The details, updated to the middle of last month, were supplied by IFR Securities Data, London and other sources.

Issuer	Amount raised (m)	Type of issue	No shares (m)	Offer price	Pricing date	Exchange listing	Fees (%)	Bookrunner
<b>Fountain Company</b>	EUR33.7	P, S	0.6	EUR56	24 Apr/99	Brussels		Banque Degroof Banque Bruxelles Lambert SA
<i>Comment: Proceeds will be used to fund expansion in Germany and Eastern Europe.</i>								
<b>Goldman Sachs</b>	USD243.8 USD487.6	P, S	4.6 9.2	USD53	3 May/99	New York	4.25	Goldman Sachs (Asia)
<i>Comment: The proceeds will be used to grow the M&amp;A and fund management businesses.</i>								
<b>McGregor Fashion Group BV</b>	EUR15.6	P, S	1.39	EUR11.25	29 Apr/99	Amsterdam	3.75	Rabo Securities NV
<i>Comment: Proceeds will be used to expand the brand name in international fashion markets.</i>								
<b>MIH</b>	USD93.92	P	5.22	USD18	13 Apr/99	Amsterdam NASDAQ	7.00	Merrill Lynch
<b>Securitas AB</b>	SEK972.16 SEK2499.84	S	7.84 20.16	SEK124	20 Apr/99	Stockholm	3.10	Deutsche Bank AG
<b>Synergon</b>	HUF1080	P, S	0.4	HUF2700	23 Apr/99	Budapest	4.00	Nomura International Creditanstalt Investment Bank
<i>Comment: The proceeds will be used to finance growth, fund acquisitions and efforts to build the outsourcing business.</i>								
P = primary; S = secondary; IPO = initial public offering; D = demerger.								