

## REGIONAL MARKETS UPDATE

## EUROPE (3.0 STARS – ATTRACTIVE)

## GERMANY

- Industrial production rose 0.8% m-o-m in Oct 11 following a downwards revised -2.8% contraction in Sep 11
- German IFO Business Climate index rose marginally to 107.2 in Dec 11, up from 106.6 in Nov 11
- PMI manufacturing rose to 48.4 in Dec 11, up from 47.9 in Nov 11
- PMI services rose to 52.7 in Dec 11, up from a downwards revised 50.3 reading in Nov 11
- Factory orders rose by 5.2% m-o-m in Oct 11 following downwards revised -4.6% m-o-m in Sep 11

## FRANCE

- Industrial production failed to grow m-o-m in Oct 11, improving from Sep 11's downward revised -2.1% contraction
- PMI services rose to 50.2 in Dec 11, up from a 49.6 reading in Nov 11
- ILO unemployment rate rose to 9.7% in 3Q 2011, up from 9.6% in 2Q 2011

## EUROZONE

- Euro-zone retail sales contracted by -0.4% m-o-m in Oct 11 following a -1.5% rate in Sep 11
- Euro-zone PMI composite rose to 47.9 in Dec 11 following a reading of 47 in Nov 11
- Industrial production fell -0.1% m-o-m in Oct 11, following a -2.0% contraction in Sep 11
- Euro-zone core CPI rose by 1.6% on a y-o-y basis in Nov 11, the same rate as in Oct 11

## UNITED KINGDOM

- ILO unemployment rate remained at 8.3% in Oct 11
- Industrial production fell by -0.7% m-o-m in Oct 11 after a 0% growth rate in Sep 11
- Retail sales excluding auto fuel fell -0.7% in Nov 11 after an upward revised growth of 0.9% m-o-m in Oct 11
- Core CPI rose 3.4% y-o-y in Oct 11 following a 3.3% growth rate in Sep 11
- Manufacturing production fell -0.7% m-o-m in Oct 11 after a downward revised 0.1% growth rate in Sep 11

## MARKET OUTLOOK

The month of December has been a relatively good month for the troubled continent. Economic data coming out of Europe has seen the powerhouses of Europe keep their economic engines from a complete shutdown. Factory orders in Germany came in at an astounding 5.20% on a month-on-month basis in October, smashing estimates of a 1.00% rate forecasted by consensus. On a year-on-year basis, factory orders rose by 5.40%, easily beating estimates of a 1.90% rate. Over in France, industrial and manufacturing production grew on a year-on-year basis, posting growth rates of 1.80% and 2.60% respectively for the month of October.

However, the economic weakness in the peripheral states has yet to be resolved. Industrial production in Italy has continued to contract, with month-on-month data showing a contraction of -0.90% in October following an upward revision of a -4.60% contraction in September. On a year-on-year basis, industrial production in Italy has contracted by -4.20% in October following a -2.70% contraction in September. Industrial orders in Italy have continued to disappoint. Industrial orders in Italy have contracted by -1.60% and -4.80% on a month-on-month and year-on-year basis respectively. With retail sales continuing to fall in Italy (down -1.50% on a year-on-year basis), President Mario Monti's structural reforms could not come too fast.

On a policy level, Europe has had an extremely positive month. With the global cooperation by several major international central banks to provide unlimited USD liquidity to the financial system, particularly targeted at Europe, the credit crunch in Europe has been given a booster jab. On a more significant note, the European central bank's rate cut to bring the refinancing rate back to 1% (as it was at the beginning of 2011), and more specifically; the introduction of unlimited 3 year loan program has been a success in terms of 532 banks taking approximately EUR 490 billion in loans. The funding program should aid the finances of banks; ease the credit crunch and liquidity crisis in the financial sector. However, the funding program has failed to entice banks to buy up the sovereign debt and bring down the yields of the likes of Italy and Spain. While the ECB has resisted the idea of printing money, the current loan program could be interpreted as the ECB executing both Quantitative and Qualitative Easing by expanding the riskier and more illiquid composition of its balance sheet as well as increasing the composition of assets it deems as "appropriate collateral".

Despite much negativity about the European continent, much of the negative news and possible outcomes have already been priced into the market. Recent bond auctions by both Italy and Spain have seen the yields on their national debt fall to more acceptable levels, despite remaining precariously high.

The Stoxx 600 index rose moderately in December, closing at 244.54 for 2011, a 1.9% monthly gain, but losing -13.2% for the year (in local currency). At its present level, the market trades at a PE ratio of 9.6X and 8.7X based on forward 2012 and 2013 consensus estimated earnings respectively, a significant discount to our target fair PE of 12.5X. Using our conservative adjusted earnings based on expectations of a mild recession, we derive a PE ratio of 12.0X and 10.2X for 2012 and 2013. We **maintain our rating for Europe at "3.0 stars – Attractive"**