



September 30, 2011

Dear clients and colleagues:

The economic outlook for 2011 has come down considerably in the past few weeks, led in part by the euro-zone woes. In this confidence crisis, investors' risk appetite has decreased substantially. Following the recent selloff, we recommend investors not flee the Euro-zone.

Although we are uncertain how, the Euro-zone situation will be resolved. We believe policy makers will ultimately agree on a plan to tackle the Greek situation, undercapitalized banks and the overall debt situation in many countries. Any solutions will be socially hard to implement and several countries are set to pass further unpopular austerity measures. In the meantime, financial markets should remain very volatile.

But all the negative news from Europe hides a level of corporate confidence which is far less pessimistic than headlines would suggest. Following meetings and discussions we have had with many European companies in the last few weeks, we feel the European market is undervalued. Here are a few observations to support our conclusion.

- Corporate balance sheets are in a much better position than they were prior to the financial crisis of 2008. That allows companies to be more flexible in growing their businesses without requiring bank debt.
- Companies and insiders are proactive on share buybacks and increasing their dividend payout. The recent decision of Warren Buffet to buy back Berkshire Hathaway shares is a good example.
- Mergers and acquisitions activity should increase. Many companies have mentioned the intention to make a strategic acquisition in the next year and indicated the current environment is more favorable than ever.
- Cost structures are more flexible. Following the 2008 crisis, many companies aggressively reduced costs which mean they should remain profitable even with lower sales.

The companies in our portfolio are expected to grow earnings by more than 10% next year. They offer an attractive dividend yield close to 4% compared to around 2% for 10 year bonds.

Time to Buy!

Have a good week.

The Global Alpha Team

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