January 31, 2014

Dear clients and colleagues,

It is cold here in Montreal, and in most of North America for that matter. With this cold winter, natural gas prices are approaching $5 and going higher. We are still optimistic about that commodity and believe that the long term price will be between $5 and $6.

This week, we will expand on our last comment following the trip that two of us did the last few weeks in Europe (France, Switzerland, and Germany).

In Q4 of last year, Europe officially came out of recession. Some Countries like Germany and the Nordics had stronger growth. The UK has enjoyed a surprisingly strong recovery and the Bank of England may be the next Central Bank to remove stimulus. The biggest surprise however came from Italy and Spain, two of the larger Eurozone economies. Both grew, led by exports strength, and to a lesser extent, domestic demand recovering. Labor reforms adopted in late 2011 and early 2012 are starting to have an impact. For more details, please read our April 20, 2012 comment. As discussed last week, the big laggard remains France where real reforms have yet to follow the rhetoric.

Although improving, Europe's unemployment rate is still very high, damping confidence. The Euro is too strong, hurting exporters. Governments' and Banks' balance sheets still have too much debt. For those reasons, the recovery will be muted at best.

We attended many conferences during the trip. Here are some of our observations:

- There is no more talk of crisis. Most of the companies are cautiously optimistic for 2014.
- For many European companies, the biggest growth opportunities are in Emerging markets and the US.
- To accelerate growth, many companies discussed M&A, mainly in the above regions.
- Cash flow generation and dividend increases are objectives for 2014.
- R&D spending will be increased.

Many companies, especially German, mentioned the headwind created by a strong Euro. For many, their most important Global competitor is Japanese.

We met many of our existing holdings at the conference and came out very confident with the outlook for 2014. In terms of valuation, EV/Ebitda, P/S, etc., many European companies are selling at substantial discount to US peers.

We are optimistic on the European equities in general, an article in the Financial Times yesterday morning stated that US purchases of European stocks surged and was the highest since 1996 and will most likely continue in 2014 given the lower valuations and lower systemic risk.

Have a good week.

The Global Alpha Team