

International Equity Monthly Newsletter July 2010

Review

International equity markets moved upwards across the board in the month of July, and while W.P. Stewart accounts also moved higher in the month, they gave some ground against the indices having performed strongly in the first half of the year. Overall global markets moved up 9% in aggregate, as international investor concerns on Greece dissipated and Chinese policy efforts to move the economy onto a steady growth footing gained credibility.

Compared to the prior half of the year, we saw gains in the month being concentrated into a handful of sectors, notably Financials, Energy and Telecommunication Services. Two of these had been lagging year-to-date, whereas Energy as a whole benefited from the BP issue starting to see light at the end of the tunnel. Healthcare, Consumer Staples and IT were laggards. At the market level, both the Swiss and the Japanese indices were relatively weaker though positive, while the FTSE in the UK and the CAC of France had a relatively strong month.

The bulk of second quarter earnings came in broadly ahead of expectations, particularly for those companies that are more cyclical in nature. In European companies, there was an element of “traveling and arriving” with markets moving to discount strong earnings in anticipation of their being posted.

Portfolio Changes

In the month, we added to three positions in client portfolios: these were Autonomy of the UK, Danone of France and Daphne of China.

Autonomy continues its emergence as a leading global software company, run out of Cambridge, UK, from where it dominates the niche area of corporate e-discovery for businesses that increasingly need to structure their unstructured information such as emails and voicemails for legal and compliance purposes. We took the opportunity around earnings season to augment our position. The same holds for Daphne, a footwear manufacturer and retailer in peninsular China. The stock had corrected for some floods around the bank of the Yangtze River affecting retail sales, but our belief is that this will be short-lived and offset by replacement demand and underlying growth further down the line. With Danone, the earnings were a slight disappointment at the margin, but their top line continues to be stellar following a pricing reset earlier in the year, particularly in relation to lukewarm reports from its peer group. We believe that their focus on a healthy food portfolio will be a key driver of above market growth.

We funded these position increases, partially from cash and partially from trimming our position in Novo Nordisk. We remain committed to the Novo growth story but do feel its year to date strength has moved the stock somewhat ahead of its fundamentals at this juncture.

Review

International equity markets continue to throw out mixed economic signals with global data-points being surprisingly strong one month, such as the manufacturing numbers released in July – and then weak the next. Added to this is the issue that many of the worlds’ monetary and fiscal regimes are pushed to extremes. We wrote last month that “we firmly believed equity valuations are underpinned at these levels ... when international markets’ thoughts were of a return to the great depression” and this still holds true with forward earnings multiples within a couple of points of their March 2009 level. We still expect global growth to be solidly positive in 2010 and 2011 albeit somewhat skewed to the emerging markets. Corporate balance sheets remain robust, productivity has never been higher and earnings growth remains strong even on somewhat reduced estimates.

For the international investor, it is this bifurcation of growth we are focused on, and how best to capture the correct earnings streams in client portfolios. We exited the month with 3% cash holdings on balance. The key for us at W.P. Stewart is to make sure we can find companies that can grow even in this challenging environment. If we are able to do this we not only believe we will provide returns equivalent to that earnings growth over the long term but also expect to see some P/E expansion to reflect the paucity of growth that is to be found elsewhere.