

The Markets – A Review

ACTIVE FUNDAMENTAL EQUITY | EUROPEAN EQUITY TEAM | MACRO INSIGHT | JUNE 2017

The MSCI Europe Index returned -2.5% month-over-month following four consecutive months of positive performance. Financials were the best-performing sector led by diversified financials and banks (+1%), whilst the biggest laggards were food & staples retailing (-8%), retailing (-7%) and energy (-6%).¹

Following speeches from various central bankers in Sintra (Portugal), there were early signs of the reflation theme being back in the market, driving a rotation into cyclicals. The European Central Bank (ECB) shifted to a more 'hawkish' tone seeing risks to growth as 'balanced' caused the market to refocus on tapering.

In Germany, the Ifo Business Climate reached a new all-time high, printing 115.1 (versus consensus 114.5), industrial production expanded whilst manufacturing orders contracted. Macro-economic data in Europe remain positive although the magnitude of improvements has declined.

Crude continued to fall (-4.7% month over month) driven by OPEC meeting failing to meet expectations on production cut and stronger-than-expected production from Libya.²

In the U.K., the general election produced a surprise hung parliament, driving conservatives to secure a deal with the Northern Ireland Democratic Unionist Party (DUP) to command a majority.

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¹ FactSet, July 2017.

² Morgan Stanley Research, July 2017.



The U.K. economy is slowing down, as U.K. industrial production came in at 0.2% (versus consensus 0.7%) and Retail Sales fell by -1.2% (versus consensus 0.8%). U.K. consumer confidence fell sharply and the household saving rate fell to historic lows. The Monetary Policy Committee (MPC) was surprisingly 'hawkish', with three members voting for a hike.

In Italy, the electoral law reform had a major setback, lowering the probability of an early election this year, and the Eurogroup approved EUR 8.5bn of extra funding for Greece (allowing the country to meet its payment obligations in July). The Greek government has outlined plans to return to the financial markets for the first time since 2014, planning to sell five-year bonds to investors.

In June, the best-performing sectors in the European equity markets were:³

- Financials (+1%)
- Materials (-1%)
- Industrials (-2%)

June key laggards:³

- Energy (-5%)
- Telecommunications (-5%)
- Utilities (-4%)

YTD, the best-performing sectors in the European Equity markets are:³

- Technology (+12%)
- Industrials (+12%)
- Consumer Staples (+10%)

YTD key laggards:³

- Energy (-10%)
- Telecommunications (+2%)
- Materials (+3%)

MSIM European Equities

During the month, the MS INVF European Equity Alpha Fund made some profit from its investment in U.K. insurance company Prudential and Dutch semiconductor company ASML. We topped up our exposure to French health care company Essilor and Spanish IT company Amadeus.

The MS INVF European Equity Alpha Fund remains overweight health care, technology, telecommunications and consumer staples; it remains underweight energy, industrials, real estate, consumer discretionary, materials and utilities.

In the MS Eurozone Equity Alpha Fund, we made some profit from investment in Dutch semiconductor company ASML, French retail bank BNP Paribas and Italian asset management company Azimut. We topped up our exposure to French health care company Essilor and Spanish IT company Amadeus.

In the MS INVF Eurozone Equity Alpha Fund, our biggest overweight sectors are industrials, health care, technology, and telecommunications. We are underweight utilities, real estate, consumer staples, financials and materials.

In the MS INVF European Champions Fund we topped up our exposure to Swiss pharmaceutical company Novartis and took some profit in Spanish biotech company Grifols and Spanish IT company Amadeus.

The portfolio remains overweight consumer discretionary, consumer staples, technology, healthcare and industrials. It remains underweight materials, utilities, energy, telecommunications and financials.

Information in this section is as at 30 June 2017 and is subject to change on a daily basis. This data is provided for informational purposes and is not intended to be an investment recommendation in regards to any securities, sectors or countries mentioned herein.

Consider This

- The recovery is becoming more self-sustaining, as evidenced in the availability of cheap bank loans, a turnaround in construction permits and further tightening in the labour market. Unless this upswing is derailed by political risk (German elections in September), the outlook should remain favourable.⁴ In the short-term, we do not exclude a pull-back in the market, given the recent rally and a slowdown in economic activity.
- Earnings per share (EPS) revisions appear to have rolled over in all the key regions, including Europe. Some recent weak Chinese data and mixed U.S. dataflow could affect earnings growth in the second half of 2017. A stronger euro could also be a specific issue for some eurozone exporters, including German exporters, which have done very well since the bottom of the market in 2009.
- A clear disappointment in earnings during the third or fourth quarter will probably be the catalyst to send the market marginally lower, especially given current valuations.
- Recent soft data on inflation allow developed markets' central banks to remove monetary policy accommodation progressively over the course of 2018. Morgan Stanley economists expect the ECB to announce tapering of quantitative easing in September this year, starting from January 2018 and ending in mid-2018.⁵ An absence of inflation could also mean that bond yields may remain flattish for the time being. This will have implications on equity sector leadership.

³ FactSet, July 2017.

⁴ Citigroup Global Research, July 2017.

⁵ Morgan Stanley Research, June 2017.

Performance in % – Morgan Stanley Investment Funds (MS INVF)*Data as at 30 June 2017.*

| | 1 MONTH % | YTD % | 1 YEAR % | 3 YEARS ANN. % | 5 YEARS ANN. % | 10 YEARS ANN. % |
|--|----------------------|------------------|---------------------|---------------------------|---------------------------|----------------------------|
| MS INVF European Equity Alpha Fund | -2.71 | 6.98 | 15.96 | 4.31 | 9.45 | 2.56 |
| MSCI Europe Index | -2.48 | 6.68 | 17.96 | 6.03 | 11.17 | 2.33 |
| ALPHA | -0.23 | 0.30 | -2.00 | -1.72 | -1.72 | 0.23 |
| MS INVF Eurozone Equity Alpha Fund | -3.04 | 8.14 | 24.59 | 7.20 | 13.81 | 3.16 |
| MSCI EMU Index | -2.53 | 8.45 | 24.82 | 7.08 | 13.16 | 1.18 |
| ALPHA | -0.51 | -0.31 | -0.23 | 0.12 | 0.65 | 1.98 |
| MS INVF European Champions Fund ⁶ | -2.43 | 10.17 | 14.51 | – | – | – |
| MSCI Europe Index | -2.48 | 6.68 | 17.96 | – | – | – |
| ALPHA | 0.05 | 3.49 | -3.45 | – | – | – |

Source: Morgan Stanley Investment Management

Note: Past performance is not a reliable indicator of future performance. Performance is shown net of fees and for the I share class, in base currency of EUR.⁶ Inception date of the Fund is 8 April 2016.

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