

International Equity Select/May 2010

Comments on Europe

On May 10, 2010, European policymakers announced a nearly \$1 trillion loan package in an effort to end the recent sovereign-debt crisis, which originated in Greece. Governments of the 16 nations in the European Monetary Union (EMU), which share the euro as a single currency, agreed to broad loan guarantees, while the European Central Bank (ECB) committed to direct purchases of private and government debt. While markets have gyrated wildly, especially in the last few weeks, our bottom-up, relative-value discipline has remained focused on individual companies; at the same time, we recognize the opportunities that this volatility has created.

We share concerns about the economic resilience of the peripheral European economies, with Greece, Portugal, Ireland, and Spain all experiencing challenges in their domestic economies (challenges that will likely remain even after this latest announcement). We believe that other sovereign debt issues may arise in Europe and around the world. However, we also believe that many financial market participants have largely ignored the improving economic picture in other European markets like Germany, France, the Netherlands, Switzerland, and some of the Scandinavian nations. Currently, core European economies have tolerable levels of debt, while increased demand from the stronger emerging markets and a weakened euro will help exporters. As a result, Europe has a range of high-quality, globally diversified companies that are trading at the lower end of their relative valuation ranges, thus creating attractive opportunities for fundamental investors that are capable of discriminating between good companies and bad.

Currently, the Lazard International Equity Select strategy has a low exposure to Greece, Portugal, Spain, and Italy. In line with our comments above, we have relatively low exposure to stocks in euro-denominated countries and high relative exposure to stocks in non-euro denominated countries. Overall, we own a collection of European stocks that have company-specific catalysts and reasons for ownership. For example, Unilever, a U.K.-based consumer goods manufacturer, derives more than half of its revenues from emerging markets. Similarly, Belgium-based Anheuser-Busch InBev's second largest global market is Brazil, where sales through its AmBev subsidiary are growing strongly and its products have approximately a 70% market share. These are just two examples of the many quality European companies that we believe are largely insulated from the domestic difficulties in countries like Greece and Spain: we feel they clearly have diverse and sustainable revenues.

Another good example is Paris-based Sanofi-Aventis, a global pharmaceutical conglomerate that sells its products throughout Europe, the United States, and emerging markets, with a cash-generative and resilient business model. The irony of equity markets is that sometimes the best stock ideas can be found in the countries that the market likes the least. The advantage of being a bottom-up investor is that we do not allow the problems of one country to obscure our view of potentially interesting opportunities. For example, Ireland is the home for cement, concrete, and construction materials producer CRH. We believe that the company is well positioned to acquire small businesses inexpensively, which we expect to be accretive to earnings. For a construction business, CRH is also much less exposed to the Irish economy (about 5% of revenues) than one might expect.

It would be foolish to underestimate the political and economic problems that Europe is facing. Some parts of the continent are clearly in the midst of the most difficult period since the inception of the euro, and some domestic economies are facing an extremely challenging future. However, from an investment perspective, there is a lot happening that bears no tangible relation to Greece or the other troubled economies.

The European economy is highly diverse and much of it is healthier than the gloomy picture portrayed in media reports. On many measures, such as product development, operational efficiency, and marketing skill, companies in the "Core of Europe"—those countries that dominate the equity markets in the region—are currently in a much stronger position than competitors domiciled outside Europe. The companies we tend to favor are highly exposed to the clear cyclical recovery in global economic growth (especially in developing economies) rather than the economic confusion that some European countries find themselves.

These are the high-quality global franchises that we seek to invest in. At today's prices, and at this stage in the economic cycle, the European opportunity set is very wide. We believe volatile share prices should provide several opportunities to enhance the profitability characteristics of our portfolios at very attractive prices. We also believe that our focused, bottom-up, stock picking approach will continue to unearth these opportunities.

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