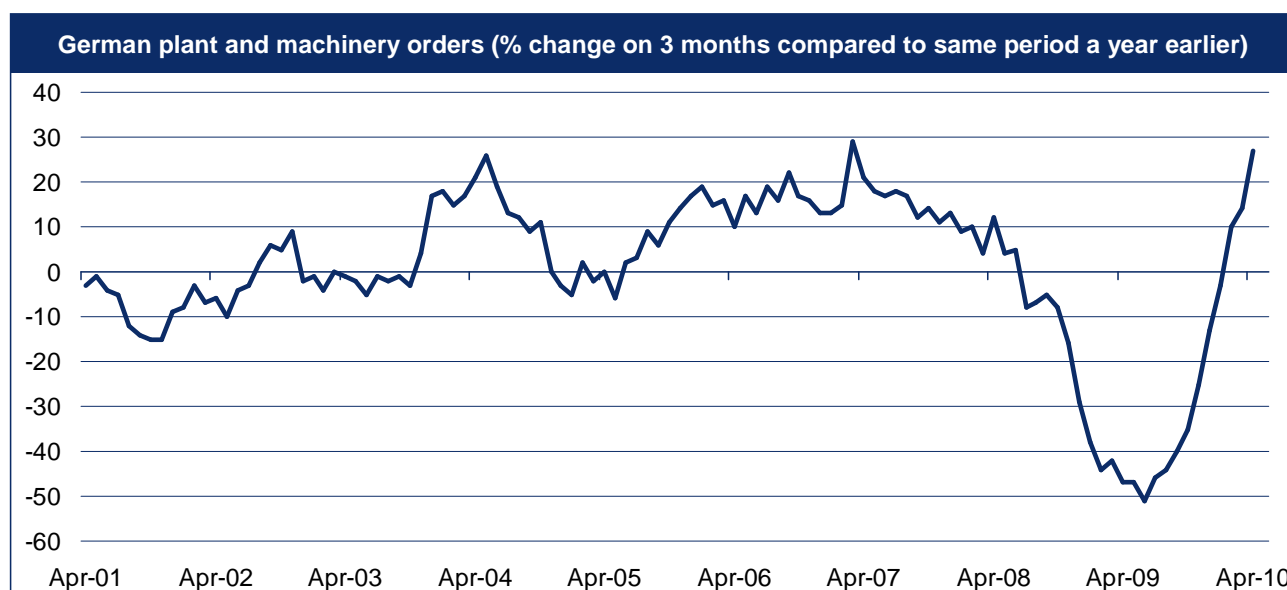


In recent months Europe has been the focal point of the debate surrounding public debt levels, with Greece acting as the lightning rod for anxiety surrounding high national debt and structural budget deficits. The country is not alone, with Portugal, Spain and the UK all vying to follow Greece and Ireland in adopting austerity measures to keep the bond vigilantes at bay.

The issue takes on a broader dimension because of the single currency, which formally links countries together. Whilst the UK enjoys the freedom of a floating currency to release pressure on the economy no such outlet exists for eurozone members who must cope with whatever level of euro the market deems appropriate. For Greek companies this has made life awkward, particularly in terms of financing. Even companies with reliable and defensive earnings such as Greek utility companies have to contend with the piercing critique that their debt is in 'hard' euros yet their earnings are generated in Greece, and as such may be vulnerable to a currency devaluation if the country was forced out of the euro. Equity markets have swung wildly as investors fret about the implications.

There are, however, two sides to every coin and amid all the reports of Greece struggling, many commentators forget that the weaker euro and low interest rates have been of benefit to companies and countries elsewhere in the eurozone. The graph below highlights that orders for German plant and machinery have recovered dramatically. The German Mittelstand – small and medium-sized businesses – are performing well as growth in the global economy devours their output.



Source: Datastream, VDMA

Any notion of Greece exiting the euro is therefore unlikely to be welcomed by Germany. Not only would it potentially weaken the wider European project but any retrenchment to a eurozone of core countries would likely lead to a re-rating of this 'core' euro and ultimately punish German exporters. Below the surface Germany is likely to be an enthusiastic supporter of the €750bn funding facility to support eurozone members.

# European Growth Fund Update

21 June 2010

More widely, many investors overlook the fact that the travails of the last few years have forced efficiencies across many companies and it is only fair that shareholders should now benefit. Ironically, gloomy headlines regarding belt-tightening and possible economic slowdown play into the hands of companies as employees are less aggressive in wage demands. With costs held in check, more revenue drops down to the bottom line, making consensus earnings growth forecasts for European companies of 39% in 2010 and 21% for 2011 eminently achievable.

Good companies, however, have a habit of doing well irrespective of the economic situation. Obsessing about market movements can, therefore, distract investors from good investment opportunities. Within the Henderson Horizon European Growth Fund we try to focus on companies that operate in niche markets or are the quality players in what they do. These are the sort of companies that we know have the product and know-how to survive a downturn and profit from a recovery.

A good example is **Fuchs Petrolub**, the lubricants business. This company distributes specialist lubricants that are key to prolonging the life of machinery or meeting strict safety guidelines. Health and safety has been brought to the fore with the BP oil spill so for many companies they are prepared to pay up for quality, especially on such a minor cost as lubricants, ensuring repeat business for Fuchs quality products. The same is true of **Kone**, the lift manufacturer. The company is well respected in the industry and builders trust in its products. This reputation is helping drive sales in fast-growing overseas markets such as China. Moreover, maintenance contracts ensure that revenues from original equipment sales are complemented by recurrent earnings from its after-sales servicing.

There is currently a mismatch between what the management of many European companies are reporting in terms of improving earnings and sales and the price accorded to these companies by the market. By ignoring the market noise it is possible to take positions in companies with strong potential at even more attractive valuations.

**Richard Pease, 21 June 2010**

**For further information on the Henderson Horizon fund range please contact your local sales office or visit our website: [www.henderson.com](http://www.henderson.com)**

#### **AUSTRIA**

Henderson Global Investors Ltd  
Falkestrasse 1  
A-1010 Vienna  
Austria  
Tel: +43 13 19 32 22 18  
Fax: +43 13 19 32 22 90  
Email: [info.austria@henderson.com](mailto:info.austria@henderson.com)

#### **GERMANY**

Henderson Global Investors Ltd  
Bockenheimer Landstrasse 24  
D-60323 Frankfurt/Main  
Germany  
Tel: +49 69 86 003 110  
Fax: +49 69 86 003 355  
Email: [info.germany@henderson.com](mailto:info.germany@henderson.com)

#### **NORDICS**

Henderson Global Investors Ltd  
201 Bishopsgate  
London  
EC2M 3AE  
United Kingdom  
Tel: +44 20 7818 1818 or ext 5011  
Fax: +44 20 7818 1819  
Email: [sales.support@henderson.com](mailto:sales.support@henderson.com)

#### **UNITED KINGDOM**

Henderson Global Investors Ltd  
201 Bishopsgate  
London  
EC2M 3AE  
UK  
Tel: +44 20 7818 1818  
Fax: +44 20 7818 1819  
Email: [sales.support@henderson.com](mailto:sales.support@henderson.com)

#### **BENELUX**

Henderson Global Investors BV  
Roemer Visscherstraat 43-45  
1054 EW Amsterdam  
The Netherlands  
Tel: +31 20 675 0146  
Fax: +31 20 675 7197  
Email: [info.nederlands@henderson.com](mailto:info.nederlands@henderson.com)

#### **ITALY**

Henderson Global Investors Ltd  
Via Agnello 8  
20121 Milan  
Italy  
Tel: +39 02 72 14 731  
Fax: +39 02 72 14 7350  
Email: [henderson.italy@henderson.com](mailto:henderson.italy@henderson.com)

#### **SPAIN**

Henderson Global Investors Ltd  
Miguel Ángel 21, 5°  
28010 Madrid  
Spain  
Tel: +34 91 562 6245  
Fax: +34 91 564 6034  
Email: [info.spain@henderson.com](mailto:info.spain@henderson.com)

#### **FRANCE/GENEVA/MONACO**

Henderson Global Investors Ltd  
7 rue Scribe  
75009 Paris  
France  
Tel: +33 1 53 05 44 80  
Fax: +33 1 44 51 94 22  
Email: [info.france@henderson.com](mailto:info.france@henderson.com)

#### **LATIN AMERICA**

Henderson Global Investors Ltd  
201 Bishopsgate  
London  
EC2M 3AE  
United Kingdom  
Tel: +44 207 818 6458  
Fax: +44 207 818 7458  
Email: [sales.support@henderson.com](mailto:sales.support@henderson.com)

#### **SWITZERLAND**

Henderson Global Investors (Schweiz) AG  
Rennweg 28  
8001 Zurich  
Switzerland  
Tel: +41 43 888 6262  
Fax: +41 43 888 6263  
Email: [info.switzerland@henderson.com](mailto:info.switzerland@henderson.com)

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