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A Good Year for Northern Exposure

By VITO J. RACANELLI

This year, investment happiness had a true North—and small-cap—orientation.

Dow Jones Global Indexes|Global Stock Markets

With a handful of days left, European stocks are winding up what looks to be a rewarding year. On the face of it, investors should be pleased with the 11% rise as of Dec. 23 in the Stoxx Europe 600 index.

Well, maybe. This increase hides a lot of sins, and happiness—if measured by stock prices, anyway—depending on exactly where you deployed your capital. This year, stocks exhibited an unusually high rate of divergent returns.

It was a "stark shift" to Northern Europe and away from the periphery or Southern Europe, notes Clas Olsson, chief investment officer of Invesco International Growth Management. "In the past, the periphery stocks were where the earnings growth was," adds Olsson, who doesn't think this shift is temporary.

Of course, large-cap-stock returns often vary from small-cap, and sectors do go in and out of style. That happened in 2010, but significant country and currency differences also affected returns.

So if Santa Claus were to bring presents to "good" investors, his list would include those holding shares of companies from Northern Europe and of industrials and luxury companies that exported to emerging markets—and the smaller the cap, the better.

Lumps of coal, however, go to investors holding Southern European or Irish stocks, or larger-cap and domestically oriented shares, as well as utilities, telecoms and financials. And returns in dollars—hence many U.S.-based investors—suffered too, because the euro is down about 20% over the past 12 months against the greenback. That, for example, turns an 11% rise in the Stoxx

NO ACCOUNT OF 2010 CAN ignore the Greek sovereign-debt crisis, which erupted last

spring and resulted in a €110 billion ($144 billion) bailout package. Ireland fell into a similar hole and received its own €85 billion ($112 billion) package last month.

But if the stock-market dip in April and May showed great fear, by the time of Ireland's bailout, equity investors showed lots of aplomb. European stock indexes fell to their lows in late May, and from that point on, the North-South divergences began to take hold. "Outside of bond markets, blind panic wasn't repeated in the Irish situation," says Edmund Shing, Barclays' European equity strategist.

Nor were Greek debt problems unexpected. "The surprise was that this became an issue so quickly, and how quickly it moved to other countries," notes Francis Claro, a portfolio manager who leads Wells Capital International Developed Markets. Germany's resistance, though it has softened, to bailing out fiscally lax countries also surprised markets.

NEVERTHELESS, ALL THIS STURM UND DRANG veiled what is shaping up to be tremendous corporate profit growth in 2010, probably an average increase of 40% over 2009. The bond-market fireworks "hid what was a very strong profit recovery in Europe," notes Gary Baker, Bank of America Merrill Lynch's European equity strategist. The 40% rise "was almost a sideshow," he says. Despite all the black ink, Baker notes, equities still dropped to a price/earnings ratio of 10 to 11 from 12 to 13 as the year began.

"Corporate operating leverage was astonishing, really surprising," adds Thomas Meier, head of global developed markets at Deka Investment. For many companies it derived more from lower costs than higher revenues, but those exporting to emerging markets saw sales rise, he says. German companies did especially well on that score.

Unsurprisingly, among Europe's big boys, Germany is set to finish with the best equity returns this year, while Spain is among the worst (see table). And at most companies, dollar- based returns are significantly worse.

North vs. South

It was a year of divergent factors for Europe, and one where currencies and countries mattered.

	2010 YTD Return*	
	Euros	USD
Stoxx 600	11.3%	1.8%
Euro Stoxx	2.0	-6.6
Germany DAX	18.5	8.4
Denmark Copenhagen 20	36.4	24.6
Spain Ibex 35	-15.4	-22.6
Greece/Athex Composite	-34.0	-40.0

*As of Dec. 23, price only. *Source: Bloomberg*

A look at sectors shows auto, industrial, resource and luxury providing powerhouse rises, while the bank and utility sectors are set to fall—the only two with negative returns in 2010. It's a good bet that if you asked the savviest investor one year ago how **BMW** (ticker: BMW.Germany) and **Volkswagen** (VOW.Germany) shares would do in 2010, for example, few would have predicted

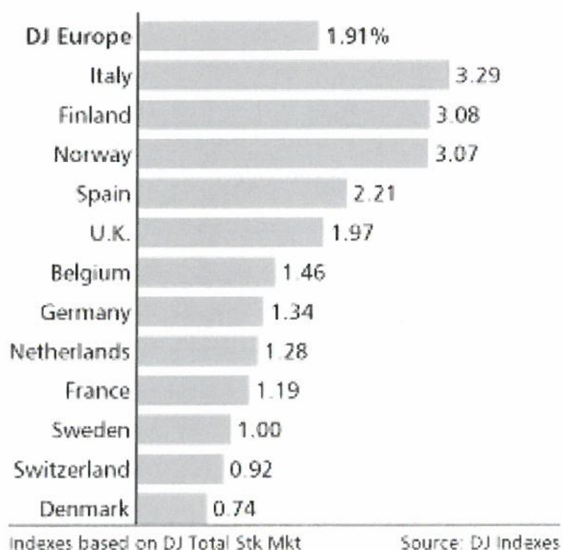
the BMW double and VW's 50% rise.

The worst stocks? If you put your money on **National Bank of Greece** (ETE.Greece), down 59%, **Piraeus Bank** (TPEIR.Greece), down 54%, or **Alpha Bank** (ALPHA.Greece), off 51%, you are battered.

All investors, however, can take some solace from a stock market that is finishing the year on a high note.

A Short but Strong Week

Stocks rose about 2% and are set to finish 2010 near highs



A Short but Strong Week: Stocks rose about 2% and are set to finish 2010 near highs

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