Quadrant
ASSET MANAGEMENT

QAM Update
June 2012

**The QAM letter that highlights recent developments that we think either affect the markets or are important to understanding them.**

"The key to making money in stocks is not to get scared out of them" – Peter Lynch

## Cautious Yes, Scared No

In our last update we talked about Greece and how it was the spark which ignited the economic crisis that currently engulfs Europe. It seems as if there has been bad news coming out of Europe every week. Country after country has been forced to seek outside assistance for financing in the face of steep interest rates inflicted by the bond markets in order to lend to or finance most Eurozone countries.

The Eurozone as a whole may have already fallen into recession; but even without the official pronouncement, signs in the Eurozone are negative: unemployment in the 17 country Eurozone has already reached over 11%. This average masks deep differences in rates of unemployment on the continent; Austria and the Netherlands are below 5.1% while Ireland is at 14.9% despite the fact that almost 2% of the population left the country in 2011. Spain and Greece are even worse; each has an unemployment rate above 20% (and higher if you consider the unemployment rate of younger workers).

Given the negative headlines published daily about Europe, it can be helpful to be reminded what equity investing is and, more importantly, what it is not. We at QAM believe equity investing is about purchasing good companies at reasonable prices which will provide value over the longer term. As the legendary investor Warren Buffett put it "If you're an investor, you're looking at what the asset is going to do. If you're a speculator, you're commonly focusing on what the price of the object is going to do." While this QAM Update focuses on Europe, investing in equities by buying good companies at reasonable prices applies to all geographical areas.

In these days of volatile capital markets and talk of "Grexits" or "Eurocalypse" it is easy to be scared off and conclude that all investment in Europe is bad. This view, however, is untrue. Even in the midst of the current Eurozone crisis there are still good companies to consider and with the decline in share values due in large part to the crisis, these companies can be purchased at a relative bargain. Two representative companies, held in investor portfolios through QAM, are the German chemical company BASF and the French power generator and rail transport maker Alstom.

**BASF** is a **German** chemical company that operates in six segments: Chemicals, Plastics, Performance Products, Functional Solutions, Agricultural Solutions and Oil & Gas. Despite being the largest chemical producer in the world, the public has seemingly forgotten BASF since it gave up its consumer products line in the 1990's. Notwithstanding, BASF has continued to prosper as a world leading chemical company. With 47% of its revenues coming from outside Europe, continued growth from the Asia Pacific region, and roughly equal revenue weighting through all of its streams of business, BASF is poised to weather a possible decline in global output. With an annual dividend yield of more than 4%, and a P/E below and ROE above the MSCI EAFE average, BASF is a firm with consistent growing sales which should provide attractive returns over the longer term.

**Alstom** is a **French** power generation and rail transport maker. Alstom provides integrated power plants and associated services for a variety of energy generation sources and technological solutions to reduce and eliminate pollutants. Alstom's website trumpets: One in four of the world's light bulbs is powered by Alstom technologies. Furthermore, it designs various solutions for the rail transport industry ranging from tramways to high speed trains. With 60% of its business outside Europe and a pioneer in the smart grid which makes existing power generation more efficient, Alstom demonstrates steady sales growth bolstered by emerging markets and a growing offshore wind business. Alstom's stock price was negatively impacted by the nuclear disaster in Japan but its base of business has not changed making it an example of a contrarian buy.

| | P/E | P/B | Dividend Yield | ROE |
|---|---|---|---|---|
| Alstom | 9.96 | 1.69 | 3.1% | 17.5% |
| BASF | 9.11 | 1.98 | 4.4% | 27.2% |
| MSCI EAFE Index | 15.17 | 1.37 | 3.4% | 16.4% |

Investment opportunities in Europe should not be ignored. Both BASF and Alstom are examples of companies based in Europe but with sales both in Europe and throughout the world.

It is understandable that investors are nervous and dare we say, scared, about the stock market. The constant barrage of bad news by the media instills fear. But as Peter Lynch has also stated: "I've found that when the market's going down and you buy funds wisely, at some point in the future you will be happy. You won't get there by reading 'Now is the time to buy'."

As one financial analyst recently commented: "The thing about a bad economy is that it's not bad for everyone." Equity managers can seize the opportunity to acquire good companies in a deliberate manner – they remain cautious but not scared.

**The QAM Update will not be distributed through July and August. We wish you a great summer and look forward to resuming the QAM Update in September.**