

C A M B R I D G E A S S O C I A T E S L L C

EUROPEAN MARKET COMMENT

FRENCH AND GERMAN EQUITIES: A STEEP PRICE TO PAY

October 2003

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French and German Equities: A Steep Price to Pay

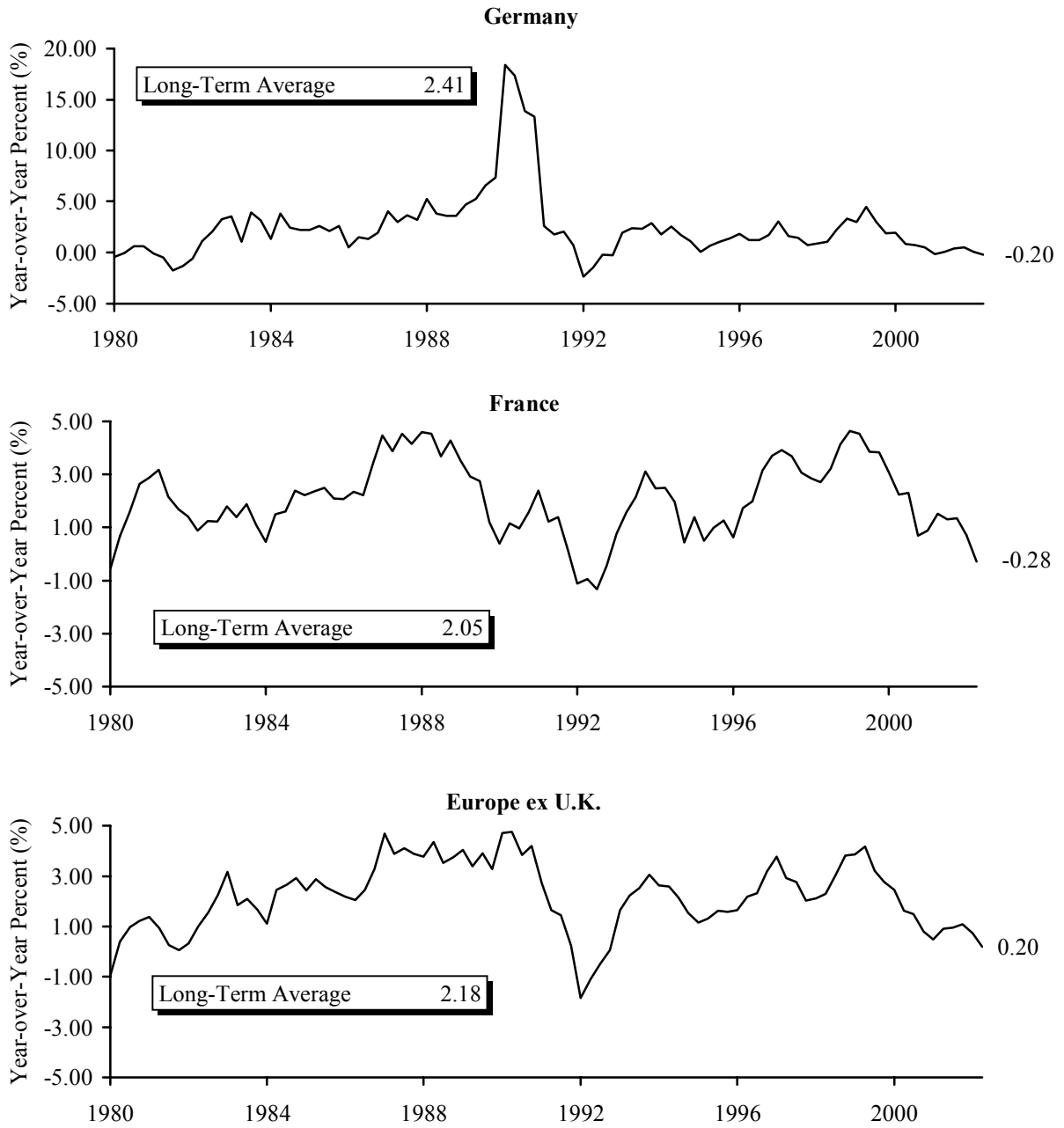
Even as business conditions around the world improve, the French and German economies remain stuck in the mud (see Table A) and analysts have been trimming 12-month forward profit estimates. This is in stark contrast to the United States, the United Kingdom, and Japan, where GDP growth has picked up and analysts are *raising* their earnings estimates. Although recent surveys have indicated that business and investor sentiment is on the mend, particularly in Germany, the price-to-earnings ratios of French and German equities are close to historical highs (far higher than those of Europe ex U.K. as a whole—see Table B), discounting extraordinary earnings growth despite persistent sluggishness. Certainly, profits are coming off a low base, and while analysts are cutting estimates, they still expect earnings growth next year of 27% for France and nearly 50% for Germany. However, if one were to accept such estimates as given, but posit that the market multiple would revert to its long-term mean over the next 12 months, this would imply a return of -35% for French and of -22% for German equities.

In short, investors in these key European markets are now paying a steep price to invest in countries where the outlook, although improving, remains fraught with considerable uncertainty and the risk of disappointment is therefore acute.

Table A

GROSS DOMESTIC PRODUCT GROWTH RATES FOR FRANCE, GERMANY AND EUROPE EX U.K.

1 April 1980 - 30 June 2003

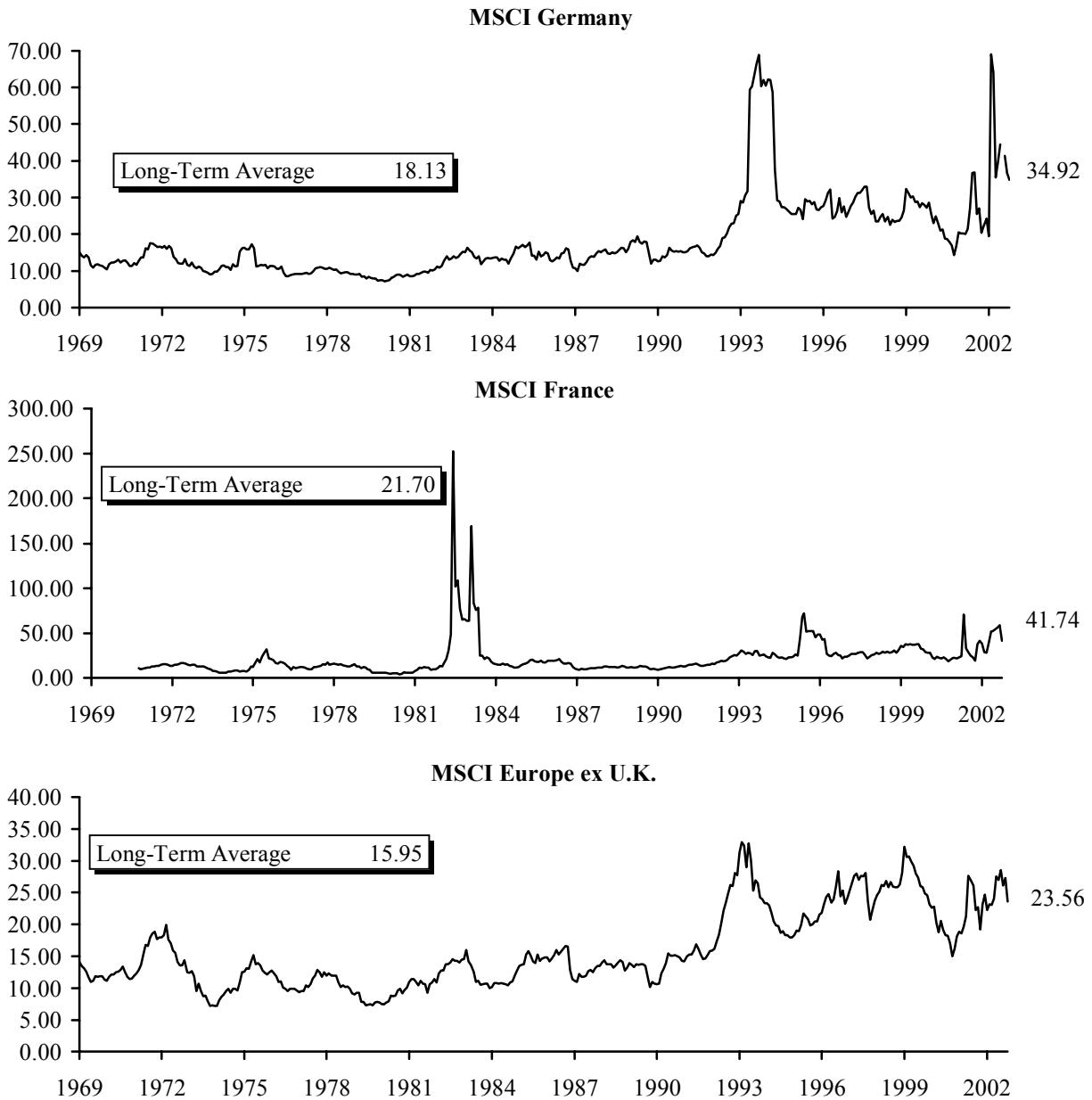


Source: Thomson Datastream.

Table B

PRICE-TO-EARNINGS RATIOS OF MSCI FRANCE, MSCI GERMANY AND MSCI EUROPE EX U.K.

1 January 1970 - 30 September 2003



Source: Thomson Datastream. MSCI data are copyrighted by and proprietary to Morgan Stanley Capital International, Inc.

Notes: Price-to-earnings valuations for MSCI France are only available from 30 September 1971. The price-to-earnings ratio for Germany on 30 June 2003 was removed as an extreme outlier at -211.30.