

SPECIAL ISSUE

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ATTRACTIVE STOCKS IN AN UGLY OLD WORLD

By Carol Matlack

Plunging prices have made European equities tempting, but proceed with caution

The Continent's leading stock indexes have plummeted more than 40% this year, and Old World companies—from steelmakers to insurers to purveyors of luxury goods—are trading at valuations not seen since the early 1980s.

The question is whether to buy now or wait for prices to drop even further. Caution seems appropriate: The gloom in Corporate Europe is deepening as recession tightens its grip. "Over the last few weeks we have seen short-notice cancellation of orders," says Jean-Pierre Clamadieu, CEO of Paris-based chemicals group Rhodia, which issued a profit warning on Dec. 8.

Even businesses that have plenty of orders are hamstrung by tight credit. "Firms could go under just because they lack liquidity," says Porsche CEO Wendelin Wiedeking. He says the automaker is paying some suppliers in advance because they can't get loans. It's no surprise, then, that many investors are hunkering down with shares in utilities, pharmaceuticals,



The strong yen and dollar should boost Louis Vuitton, says HSBC

food, and other businesses that offer reliable cash flow.

Most analysts think it's unlikely that Old World bourses will rally before the second half of 2009. Still, investors with more appetite for risk—and a willingness to pore over balance sheets—can find some good values even in cyclical businesses such as manufacturing. Bleak earnings outlooks have already been factored into many share prices. And, says Philip Isherwood, chief European equities strategist for investment bank Dresdner Kleinwort in London, managers at some companies "are becoming more realistic," trimming their forecasts and moving aggressively to slash costs.

Such companies are likely to outperform rivals even in a lousy economy, and they'll be well-positioned for the next

upturn. One example: steelmaker Arcelor-Mittal, which faces a collapse in demand from automakers and other big customers. It has announced tough cost-saving measures, including a plan to save \$1 billion by cutting some 9,000 jobs. With its price-to-earnings ratio of just 2 based on 2009 predictions, it's now turning up on analysts' buy lists.

Companies that dominate their sectors also can make good bets, as they may emerge from the downturn with a tighter grip

on their markets. "In tough times, the people who are stronger and able to invest are better off than weaker competitors," says Nokia CEO Olli-Pekka Kallasvuo. Nokia, which holds 38% of the global cell-phone market, has twice revised its 2008 sales forecast downward, but it has a healthy balance sheet and generated more than \$1.6 billion in cash flow during the third quarter. With its shares off by two-thirds in this year's market mayhem, it looks like a good buy, say managers.

Currency gyrations could produce some winners, too.

Shares of luxury-goods giant LVMH Moët Hennessy Louis Vuitton have fallen some 30% since September as key markets such as Russia and China faltered. Although LVMH's sales growth in 2009 will be only 3%, HSBC predicts earnings will jump 6% because LVMH books about half its sales in dollars and yen, which have risen sharply against the euro.

Though pickings are good, patience is a must. Morgan Stanley's European equities team is predicting a 33% drop in corporate profits next year, after a 14% slide in 2008. It's advising clients to boost cash positions and buy mainly defensive stocks, topped off with a few well-chosen cyclicals. **|BW|**

—With Jack Ewing in Frankfurt

MY BEST BARGAIN: The Investment Blogger



CHAD BRAND
President of Peridot Capital Management

Brand, the money manager and author of a blog called Peridot Capitalist, thinks Anheuser-Busch InBev is a good deal. The newly formed company, which boasts top global brands like Budweiser and Stella Artois, has been thrashed in part by investors miffed over a recent stock offering that watered down their stakes. Brand says the concern is overdone, and the company is poised to deliver strong sales despite the recession.