

**INVESTMENT NOTE**

**3 MARCH 2015**

**HERMES: SEEK QUALITY GROWTH IN 'TRIPLE ZERO' EUROPE**

*It is increasingly apparent that we now face a 'triple-zero' economy in Europe: zero growth, zero interest rates and zero inflation. Andrew Parry, Head of Equities at Hermes Investment Management, explains why quality growth companies should be the winners in this unprecedented environment.*

**Zero growth**

The US remains the envy of Europe and has continued to expand, and valuations in the two regions reflect the disparity in growth. The reality is that growth remains a scarce asset and is likely to get rated more highly still. Indeed, it could become priced well above its economic worth because of diminishing global growth expectations. This was evident in 2014, when growth stocks outperformed value names in Europe and mid-cap stocks found favour once again.

**Zero rates**

The problem with zero interest rates globally is that it has pushed valuations of most assets to historically high levels, forcing even the most prudent investor to take additional risk. With investors reaching for returns, the persistency of ultra-low interest rates is now implicit in most asset allocation models, raising questions about what happens to asset prices when quantitative easing (QE) becomes quantitative tightening. Last year was definitely a time when the unexpected happened on a regular basis, and there is no reason to expect 2015 to be any different. Volatility will continue to be a force in the markets.

**Zero inflation**

The global disappearance of inflation is another reality that investors must face. Evidence of this can be seen in Germany, where in January inflation turned negative for the first time since the height of the global financial crisis. With central bankers obsessing about higher inflation expectations – a key policy plank in restoring growth – we can expect prices to remain a focus this year. One of the ironies in the universal adoption of QE is that it has created one form of inflation – in asset prices, with the associated risks – at the expense of another: demand-led price increases.

**Identifying winners**

Despite this, we are quite optimistic about the outlook for European equities. The weak euro should benefit many European companies, and we see this as a contributor to improved corporate earnings forecasts. The lower oil price, too, should be a boon to European companies, but identifying specific winners is the key. In this triple-zero economy, growth is a scarce asset and the companies able to deliver it should command a much higher premium. In particular, we prefer those companies taking their destiny into their own hands through restructuring and other means as they adapt to the new environment. With Europe now on the right side of the QE arbitrage, investors could benefit from some positive surprises – but quality growth companies offer the best prospects of long-term outperformance.

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## Notes to Editors:

### Hermes Investment Management

Hermes is focused on delivering superior, sustainable, risk adjusted returns for our clients – responsibly.

Hermes manages assets on behalf of more than 200 clients\* across equities, fixed income, alternatives and real estate, with £28.6 billion\* assets under management. In Hermes EOS, we have the industry's leading engagement resource, advising on more than £134.0 billion\* of assets.

We believe in **Excellence, Responsibility and Innovation**

- **Excellence:** We aspire to excellence in everything we do. This manifests itself most visibly in our investment performance. We will only offer products to our clients where we believe there is a strong investment thesis and where we can deliver sustainable alpha.
- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

Our structure gives clients globally the benefit of access to a broad range of specialist, high conviction investment teams operating within an established and robust operating platform.

Hermes' investment solutions include:

- **Equities:** Global, Emerging Markets, Small & Mid Cap, Europe, Asia Ex Japan, Greater China
- **Fixed Income:** Inflation-Linked, Government Bonds, Investment Grade, High Yield
- **Real Estate:** Segregated, Unitised, Debt, UK, US Residential, European, UK PRS
- **Alternatives:** Multi Asset, Infrastructure, Private Equity

\*Please note the total AuM figure includes £3.7bn of assets managed or under an advisory agreement by Hermes GPE LLP ("HGPE"), a joint venture between Hermes Fund Managers ("HFM") and GPE Partner Limited. HGPE is an independent entity and not part of the Hermes group. £0.4bn of total group AuM figure represents HFM mandates under advice. Source: Hermes as at 31 December 2014.