European Equities Market

2013 Mid-Year Review

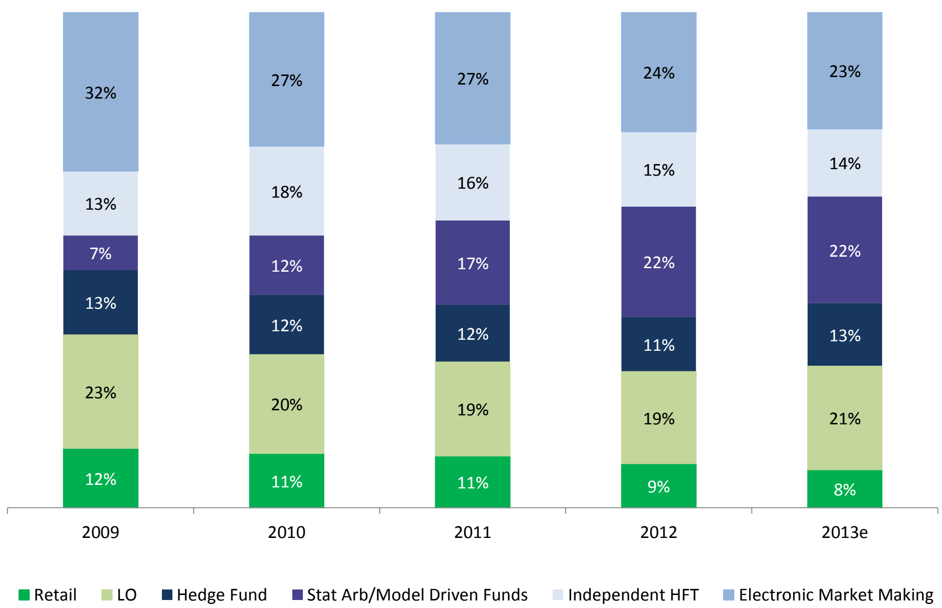
Rebecca Healey | V11:036 | August 2013 | www.tabbgroup.com

TABB GROUP

Turning Tides

The long-only investor has returned. After a continued decline since 2009, institutional market activity increased from 18.55% in 2012 to 20.93% of European notional turnover in the first half of 2013. The imposition of greater European regulation would appear, at first glance, to be having the desired effect. Both high-frequency and statistical arbitrage strategies have declined relative to long-only activity, with independent high-frequency trading (HFT) activity falling to just under 14% in the first half of 2013. Yet initial appearances can be deceptive.

European Market Participant Numbers, 2009–2013: the Return of the Long-Only Investor



Source: TABB Group

A relatively calmer Eurozone may not have resolved the underlying issues but the consensus of opinion is now that politicians will not allow the European project to fail. The Cypriot litmus test after the Draghi effect of 2012 illustrated the level of action politicians are prepared to take and has been regarded positively by institutional investors in particular.

Yet concerns over the ability of European politicians to address the crisis have been replaced by even greater apprehension that increasing regulation will stifle any growth or innovation. Taxation appears to be the modus operandi of European leaders without any evidence that there will be any revenue to collect, and every indication that market liquidity will deteriorate in the process.

The ability for long-only investors to execute institutional order flow remains heavily constrained. Electronic market making is in decline in conjunction with the relative reduction in model-driven flow. Underlying market fundamentals and lack of volatility have also played a role in reduced appetite for latency-centric strategies, creating a static market for all but the most liquid of names. With depleted margins and bank deleveraging influencing the ability for market participants to trade on risk, institutional investors will continue to automate flow. The inability to trade blocks creates a self-fulfilling prophecy, with execution costs being scrutinised and reduced even further – requiring yet more automation.

We have already witnessed dramatic changes in French and Italian market structure due to the introduction of these countries' individual financial transaction taxes (FTTs). Further European regulation currently under negotiation in the Markets in Financial Instruments Directive (MiFID) II – in particular, legislation concerning dark pool activity – could have even greater consequences, leading to structural changes in investment strategies, as well as implications for execution.

Despite the growing confidence that the worst is behind us, Europe is not out of the woods yet. A path ahead is now in sight, but much still depends on the regulatory hurdles that may yet be imposed. We continue to urge caution to avoid irreparable damage to European capital market structure, and as a consequence, the wider economy.

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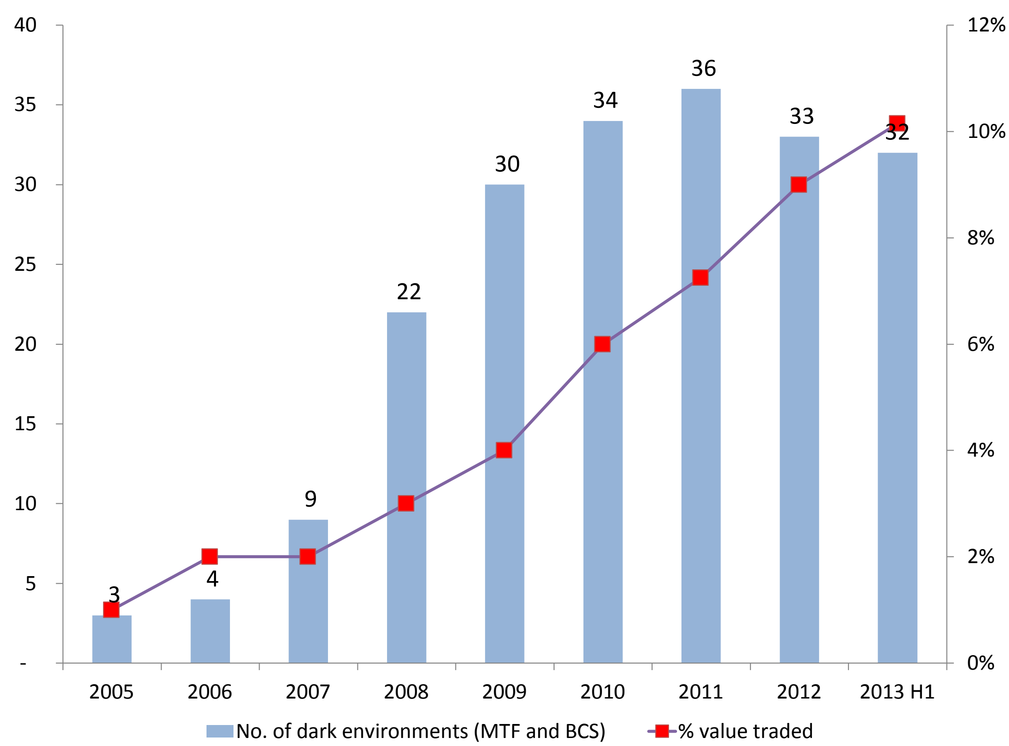
10.15%

Dark trading increased by 15% since 2012, and is over 10% for the first time in Europe

MTF flow increased 31% from 1.9% in 2012 to 2.49% by July 2013, however Broker Crossing Systems only increased by 11%

Growth of Dark Trading in Europe (2005-2013e)



Source: Thomson Reuters EMSR /TABB Group

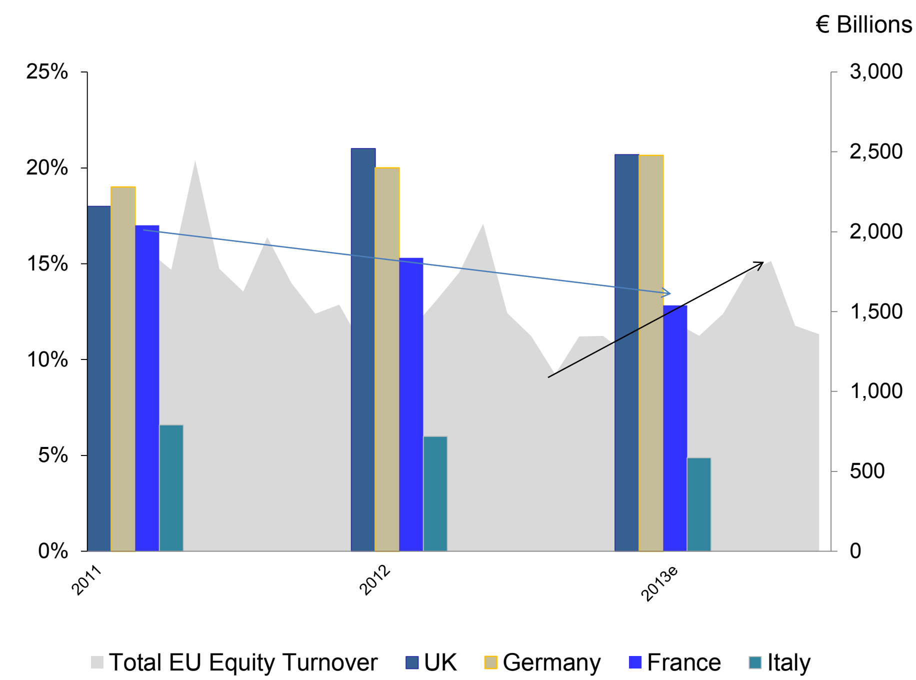
The return of long-only activity coincides with an increase in dark-trading volumes as asset managers continue to struggle to execute institutional order flow. While the use of dark multilateral trading facility (MTF) order books has almost doubled since 2011, activity in broker crossing systems appears to be plateauing, given the finite ability to cross up customer order flow up from 6.9% in 2012 to a year-end estimate of 7.65% in 2013.

13%

French market share of European equity turnover continues to decline from the 2011 peak of 23% to a year-end estimate of 12.8%

German and UK market share has increased from an average of 19% and 18% in 2011, to 21% in 2013

European Market Share vs Total Equity Turnover 2011 -2013e



Source: Thomson Reuters EMSR /TABB Group

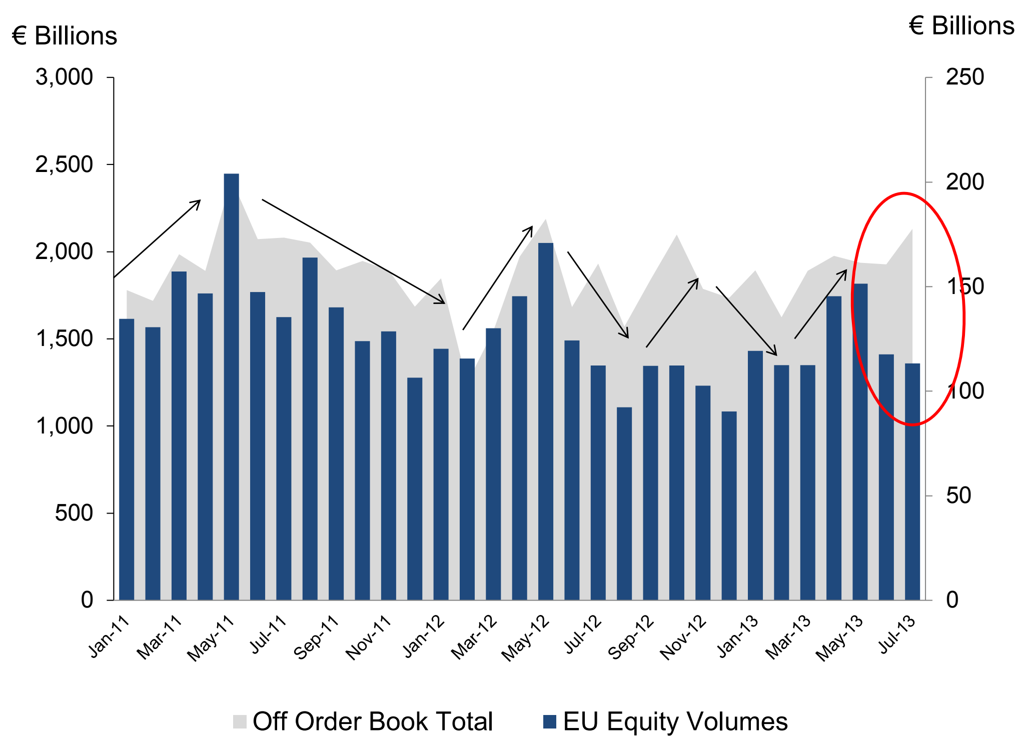
Although overall European volumes have increased in the first half of 2013, France and Italy have seen a continued decline in trading volumes and a growth in the use of synthetic instruments in France. France's market share of 20.73% ahead of the FTT declined to 12.78% after implementation, and remains at 12.45% at the end of July 2013. The decline could be attributable to a deterioration of the French economy. However, the imposition of the tax will likely exacerbate this scenario, while only raising paltry revenues. The French treasury collected less than 40% expected from the tax: €200 million instead of the anticipated €530 million.

13%

Off Exchange trading reached a new peak in July 2013 of 13.07% of volume

In March 2013, the relationship between off-order book activity and European cash-equity volumes reverses

Off Exchange Trading Volumes (January 2011-July 2013)



Source: Thomson Reuters EMSR /TABB Group

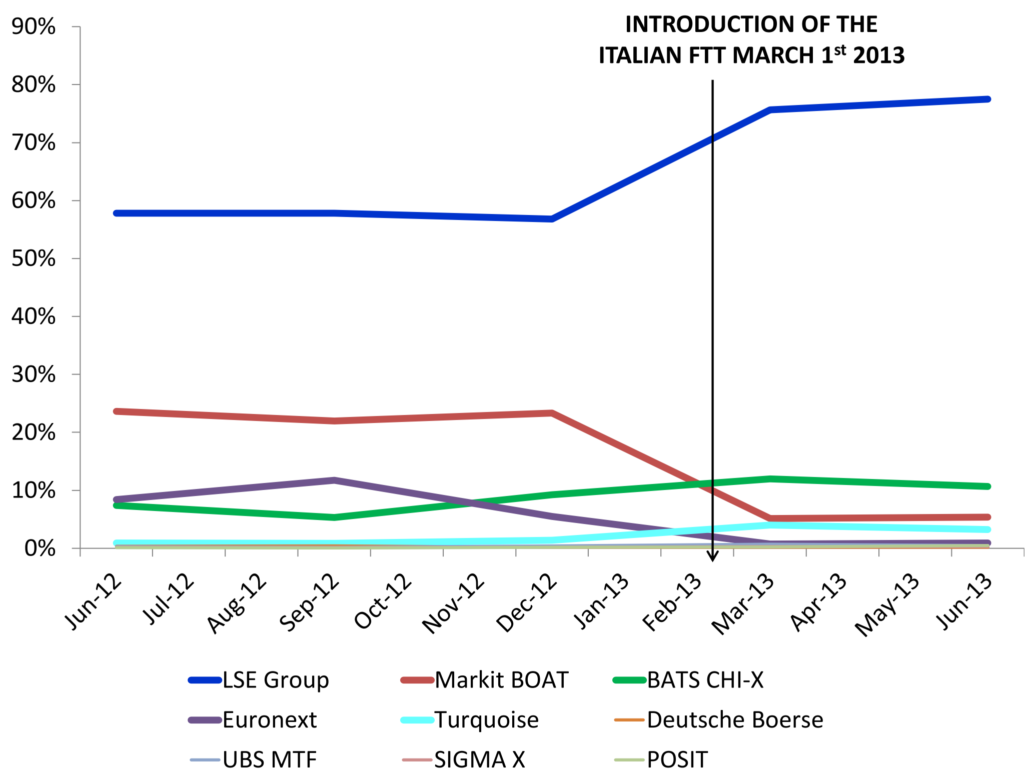
Historically the relationship between off-exchange activity has remained correlated to the overall volume of equities traded, however this reversed for the first time in March this year – the date of the introduction of the Italian Financial Transaction tax.

+20%

Italian equity volumes traded on the primary have increased from 57.8% to 77.5% in 2013

BCS activity reported to Markit BOAT has fallen – from a peak of 23.3% at the end of 2012 – to 5.4% in June 2013

Italian Equity Volumes by Venue 2012 -2013



Source: Thomson Reuters EMSR /TABB Group

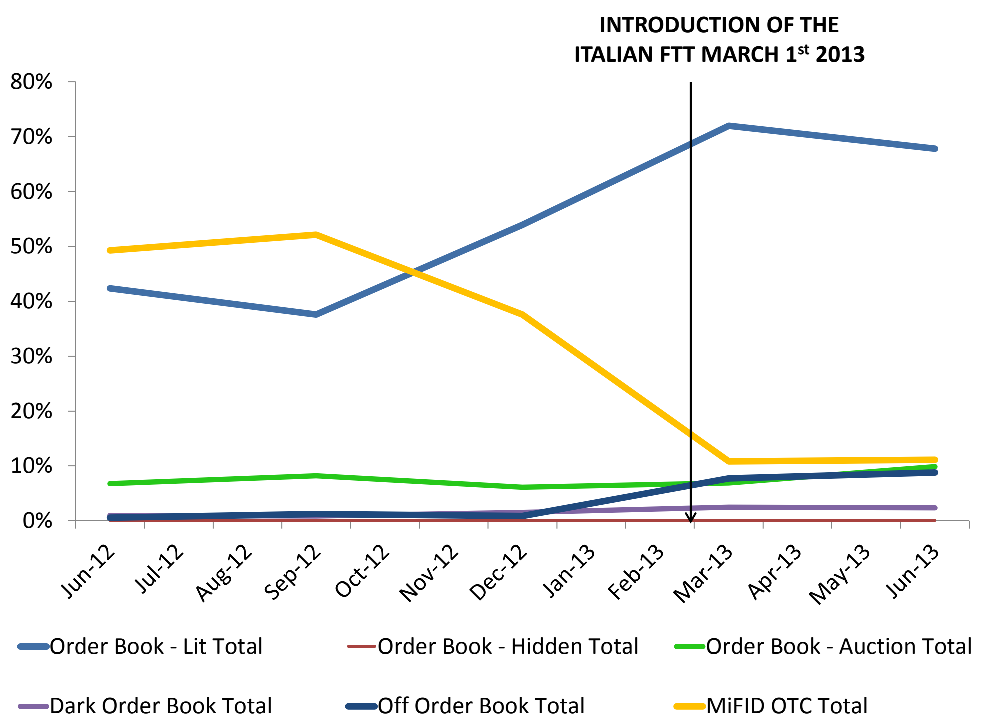
MTF activity in Italian equities has increased by 58% in the past two years, from 8.83% to 15.13% in June 2013, the majority of which (70.46%) is conducted on BATS Chi-X. However, this only accounts for 10.66% of overall volume, compared to the 78.57% of activity conducted on the primary exchanges.

-38%

Proportion of trades reported to Markit BOAT has fallen from 49% in 2012 to 11% in 2013

Off-order book trading reported on exchange increased from 0.57% to almost 9%, as participants are choosing to trade off exchange and then report on-exchange, rather than return to the lit

Italian Equity Volumes by Order Type 2012 -2013



Source: Thomson Reuters EMSR /TABB Group

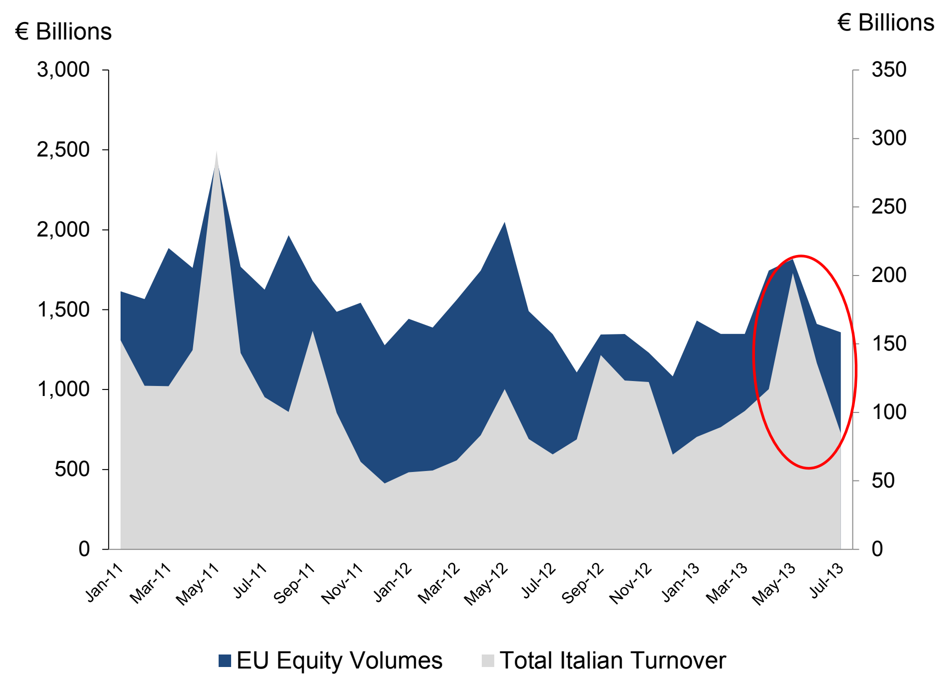
While macro-economic influences have played a part, the Italian Financial Transaction Tax – and in particular, the narrower scope of market-making exemptions – are fuelling behavioural change in Italian market structure. In Italy the FTT levies a higher rate of tax for over-the-counter (OTC) transactions, and as a result there has been greater usage of the "negotiated trade" flag for Italian equities (representing "off book, on exchange" liquidity). In comparison broker dark pool activity which institutional order flow can interact with, is in decline as the additional 0.10% tax is considered inconsistent with best execution policies.

-50%

Italian Market share has been in sharp decline since January 2013 falling below 5%

Since the start of the year, Italian equity turnover has dropped from €101bn to just €50bn, a drop of 49.87%

Italian Equity Turnover 2011-2013



Source: Thomson Reuters EMSR /TABB Group

The prospect is bleak for Italian equities. Italian equity turnover declined to just €50,732,452,581 or 4.87% of European market share in July this year. In contrast, the decline in France appears to be stabilising, with turnover increasing by 7.63% in the second quarter of this year, although the country's proportion of European equity trading remains in decline at 12.45% in July 2013.

The EU Parliament published its amendments to the wider EU-11 FTT in June 2013 and a final ruling is due later this year. A delayed and less-comprehensive FTT is the likely outcome. Any reduction in the taxation of derivatives or HFT activity will make a mockery of the original intentions of policy makers, as market participants' switch from trading the underlying equity to alternative products in order to reduce taxation liabilities.

The Parliament's latest proposals include certain exemptions for: hedging transactions for non-financial companies; sovereign debt and market making (although this excludes HFT strategies still to be defined under MiFID II revisions); a reduced rate of 0.05% for sovereign bonds and pension funds until 2017; a reduced rate of 0.005% for derivatives until 2017; and a reduced rate, by 0.01%, for repos above three months. The Parliament also expanded the product scope to spot foreign exchange and CFDs (Contracts for Difference), as well as providing the option for individual countries to apply a higher rate for OTC transactions.

The latest area of concern relates to firms engaging in HFT that will have to pay FTT on order cancellations as well as completed transactions. The question then becomes, what will be classified as HFT strategies, as under the current Parliament's proposal for MiFID II, any liquidity provider using algorithmic trading strategies will potentially fall within this scope. The new exemption for market making extends only to illiquid products, which are also yet to be determined.

While the effects on the French and Italian markets show a clear drop of volumes and a widening of bid-ask spreads, the appetite for some politicians to pursue this revenue option remains unabated. Even UK politicians at a Commons Select Committee are now proposing the government should commission an impact assessment of introducing an FTT on HFT in the UK.[1] There are two areas that remain contentious. First, they make reference to setting the FTT at the level of the "average profit" made by HFTs in the UK, which would seem difficult to establish. Second, it is still unclear whether electronic market making would fall under the tax. Within the current EU FTT proposal, the two are mutually exclusive – there is a market-making exemption, but HFTs may not benefit from this. Finally, it is not clear whether this would apply to UK-based HFT firms only or to all HFT conducted on UK platforms.

Significant controversy regarding the FTT looks set to continue. The tax continues to divide opinion, with even the head of the French central bank, Christian Noyer, urging caution.[2] German manufacturers have also recently issued statements claiming that the EU-11 FTT will have damaging impacts on end-investors and will fail to achieve its desired objectives.[3]

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[1] http://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/news/on-publ-kay-review/

[2] http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10084008/Frances-central-bank-head-warns-FTT-could-destroy-jobs.html

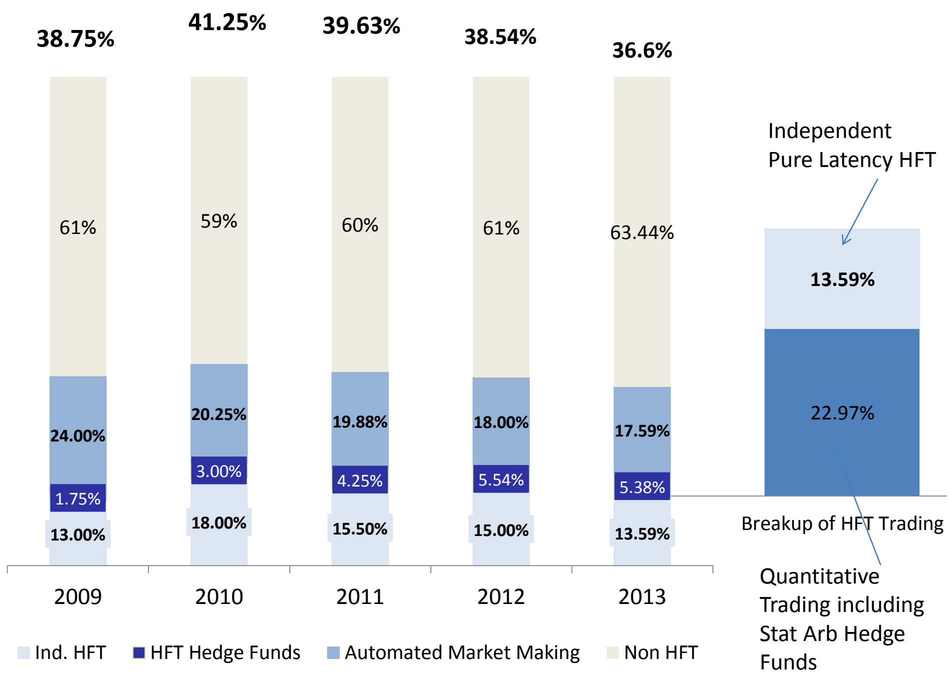
[3] http://www.ft.com/intl/cms/s/0/5cb60a60-b7d2-11e2-bd62-00144feabdc0.html#axzz2Zx6iuS95

36.6% and falling

European regulation appears to be taking effect, with HFT activity falling by 2% in the first six months of 2013

The underlying market fundamentals and lack of volatility have also played a role in reduced appetite for latency-only strategies

Decline in HFT Activity



Source: TABB Group

The German HFT Act was passed in March 2013. Now both direct and indirect participants within German regulated markets will be required to be licensed by German regulator BaFin. The rules came into force on May 15, although affected firms have between six and nine months to comply with its most onerous elements. That deadline has left German regulators and exchanges scrambling to get trading firms up to speed, fearing that uncertainty and the burden caused by the legislation could drain liquidity from the country's markets.

The final version of the rules omitted a minimum holding period for trades, which some experts advocate as a way to slow the pace of computerised trading, but it has controversially maintained a licensing requirement. This means all HFT firms that trade directly or indirectly on German markets will need to be authorised by BaFin and could have a detrimental impact on liquidity of Germany-based exchanges such as Eurex.

Germany's rules are being closely watched by the wider financial industry as a marker for future impacts of MiFID II regulation. Measures omitted by the German Act but still set for inclusion in MiFID II include a requirement of all HFT firms that follow a market-making strategy to provide continuous liquidity – or firm quotes – at all times.

MiFID II also proposes the introduction of a minimum order resting time of 500 milliseconds to slow down trading. Regulators are trying to determine whether HFT activity has helped to add liquidity for the benefit of all investors, or has threatened market stability. As such, some firms are asking themselves whether it's worth the inconvenience of continuing to trade in Germany, particularly as the rules will be overtaken by MiFID II.

Parliament vs Council

With both texts of MiFID II now agreed, the trialogue begins in September. Finalisation is expected by the end of 2013

Mid-March has emerged as the latest date by which agreement must be reached, as it will be the last plenary session before the European Parliament elections in May 2014

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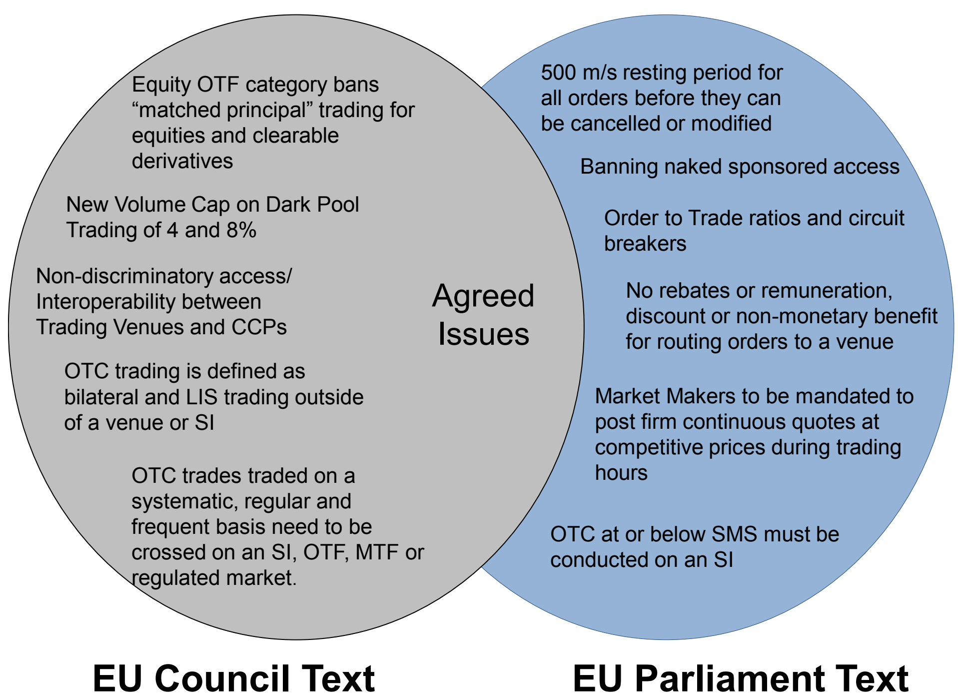
Differences between EU Council and EU Parliament Text



Source: TABB Group

9 and 16. It is not so much what is left to be agreed – open access provisions for exchanges and clearing houses, defining the role of organised trading facilities and agreeing waivers that govern dark pool use in equity markets – but which elements are non-negotiable as the inevitable horse trading begins.

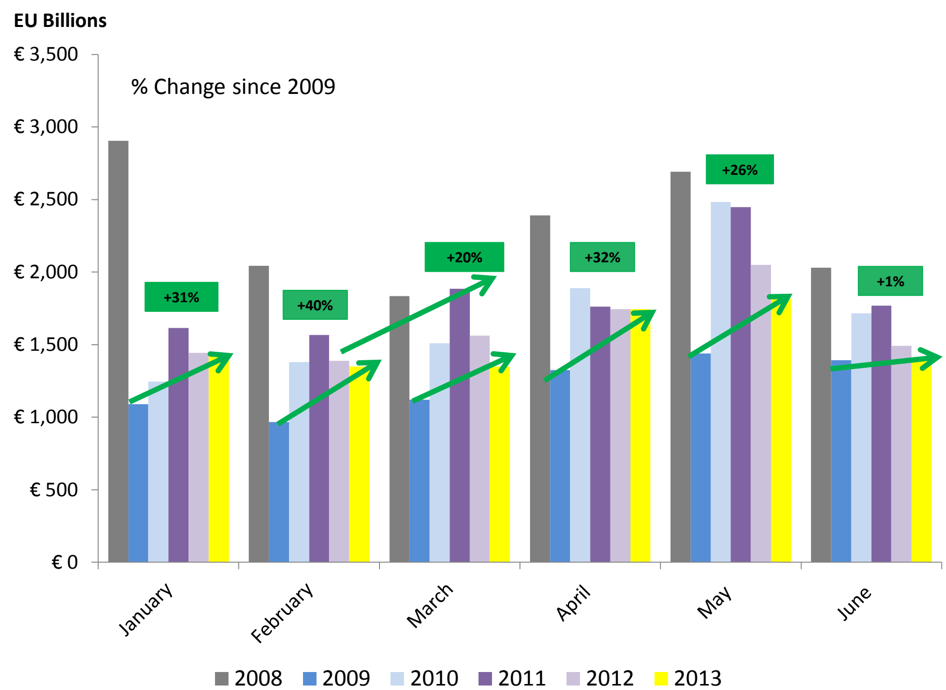
-34%

H1 2013 volumes are still on average 34% below volumes in 2008 but up 25% on 2009

European lit volumes jumped 18% in H1 2013 compared to the second half of 2012, reaching €3.66 trillion

While volumes have recovered during the first half of 2013, against 2008 figures, European equity trading volumes remain in decline. The picture since 2009 is more positive, with

European Equity Turnover (2008-2013 H1)



Source: Thomson Reuters EMSR /TABB Group

continuing month-on-month growth. Perhaps it is now time to draw a definite line under the trading volumes for 2007/08 and see those years as an abnormality, rather than expect volumes to return.

On a quarterly basis, European turnover ended Q2 2013 up 3.82% to €1.78 trillion compared with the previous quarter. Although the positive momentum declined slightly in June, 2013 pan-European turnover is now down just 5% versus 2012 year-to-date figures,, compared to being down 14% at the end of March 2013 (TABB Group's projections are flat for year-end).

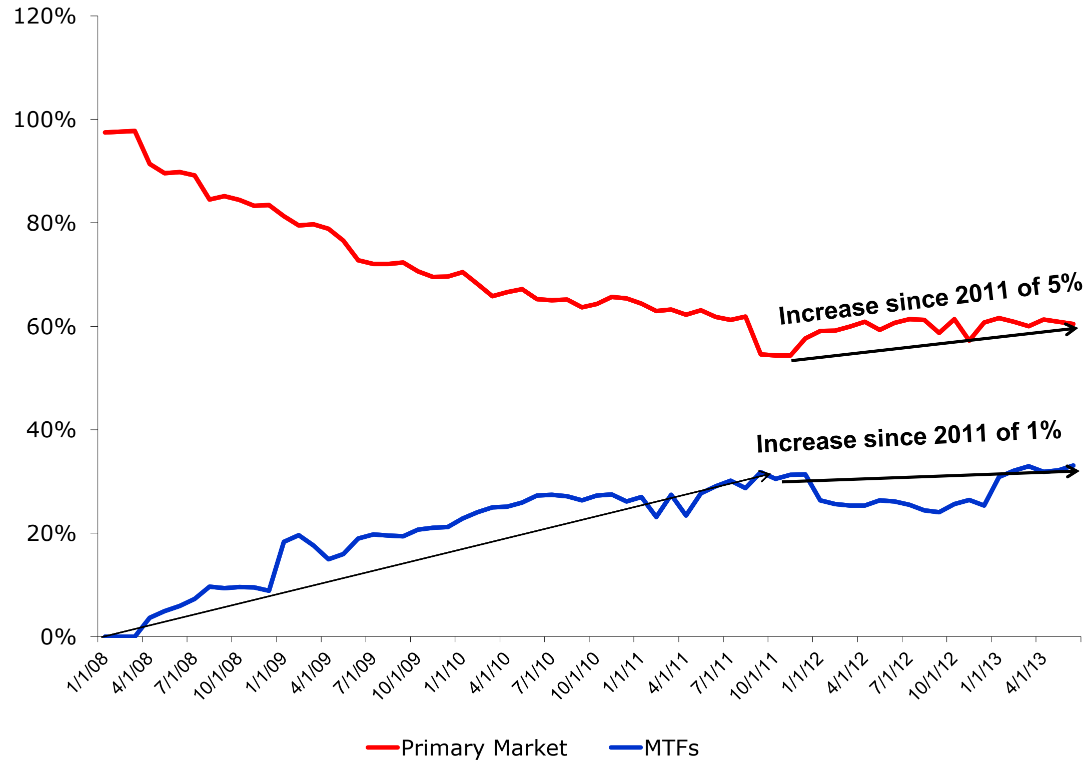
There is still room for further optimism, provided planned European regulation is not too onerous. As well as internal European optimism, foreign investment has been diluted due to large US hedge funds putting existing operations under review in response to new European regulation. Not only FTT and MiFID, but also the AIFM directive, which comes into force in July, will significantly hamper the ability of non-European alternative managers to market their products directly to European investors. Some US hedge funds and private equity funds have indicated they will just stop soliciting European investors if they can find sufficient capital elsewhere.

The directive has a more immediate impact on US rather than European houses, as European hedge funds will be eligible to apply for a "passport" that allows them to market their products to European investors with ease. Alternative fund managers outside Europe will not have this option until 2015 at the earliest. They are not eligible for the one-year transition period applicable to European fund companies that require more time to comply with the new rules.

Primacy of the Primary

The switch from primary exchanges to MTFs has stabilized; lit market share is up 5% since 2012

Volumes on Lit European Venues – Primary Exchanges vs MTFs 2008-2013 H1



Source: Thomson Reuters EMSR /TABB Group

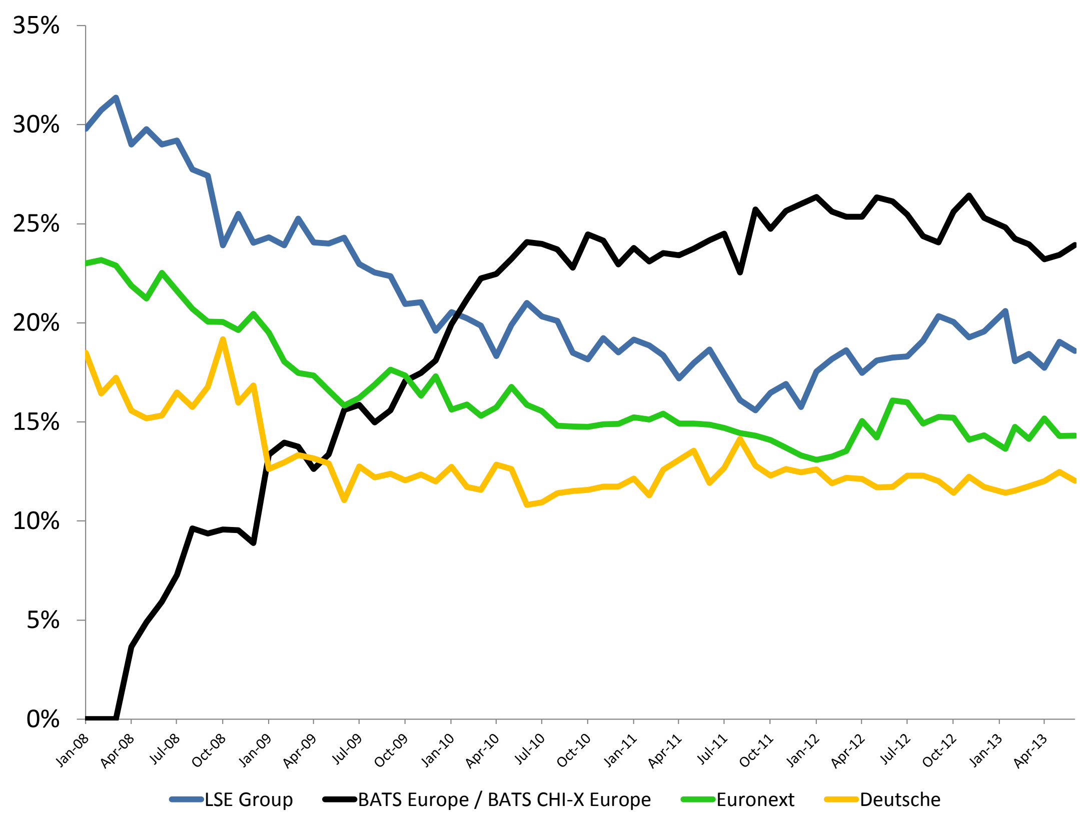
Although Turquoise and BATS Chi-X Europe reached 33.08% of equity volumes traded in June 2013, versus 44.92% traded on the three major exchanges combined (London Stock Exchange, Euronext and Deutsche Börse), the rise of the MTF is now plateauing out.

The Duopolies

Lit European equity volumes are now just traded between national exchanges and only two MTFs

Turquoise and BATS Chi-X Europe reached 23.06% of equity volumes traded in June 2013, versus 42.12% traded on the three largest exchanges combined

European Volumes across main Primary Exchanges vs BATS Chi-X 2008-2013 H1



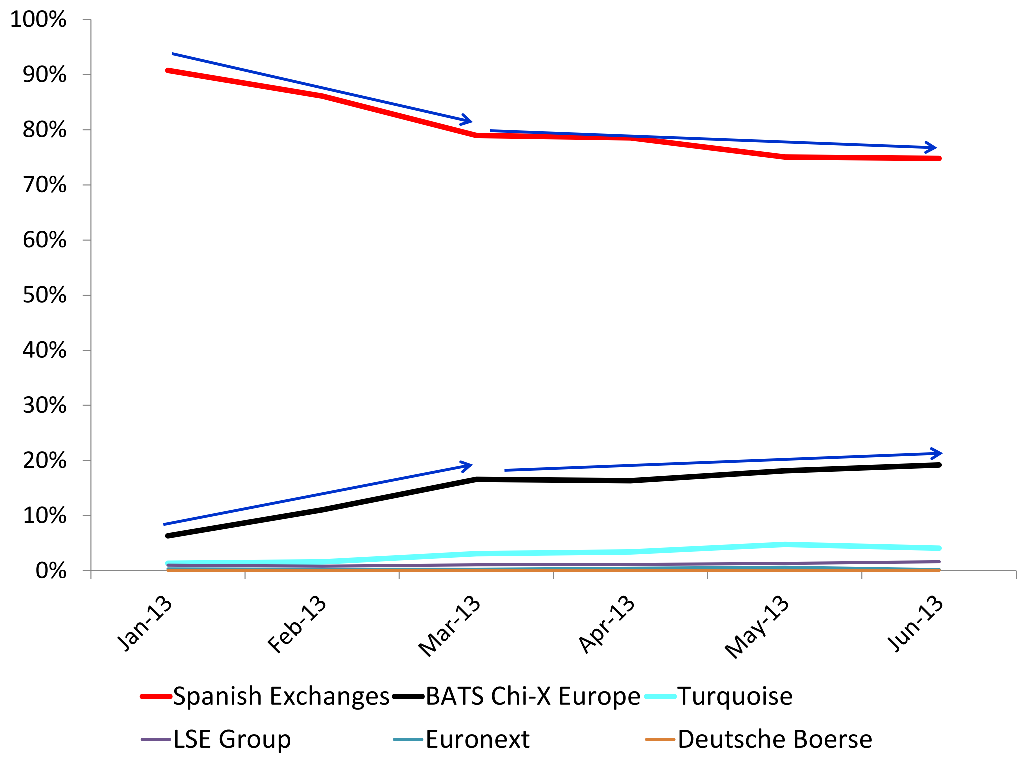
Source: Thomson Reuters EMSR /TABB Group

Spain: the Final Frontier

Spanish exchanges accounted for 90% of lit volumes at the start of 2013, falling to 75% by June

BATS Chi-X accounted for just 6% of lit volumes in January, rising to 19.17% by the end of H2 2013

Spanish Volumes across main Primary Exchanges vs MTFs January – June 2013



Source: Thomson Reuters EMSR /TABB Group

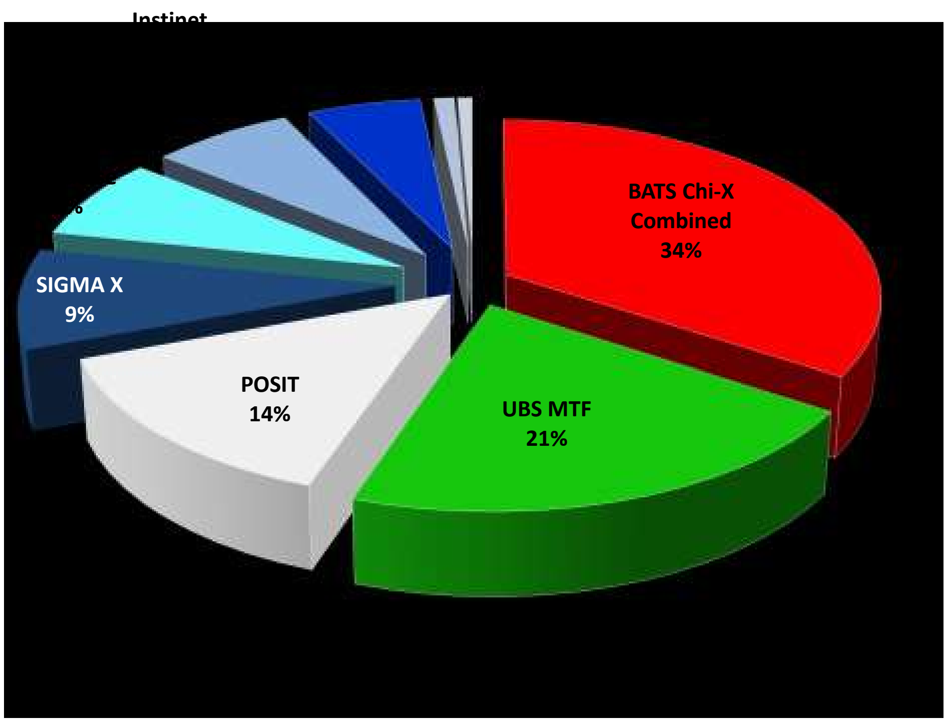
BATS Chi-X Europe has seen substantial growth in Spain in the past 12 months. Accounting for just 5% in 2012, its volume increased to over 10%. During May, its first month as a recognised investment exchange (RIE), the exchange reported a record monthly market share of 14.0% in Spain's IBEX 35 constituents.

Dark Concentration

The top-three dark MTF venues now account for almost 70% of all volumes traded

ITG Posit has increased market share, although BATS Chi-X still retains the majority at 34%

Percentage Market Share across European Dark Venues



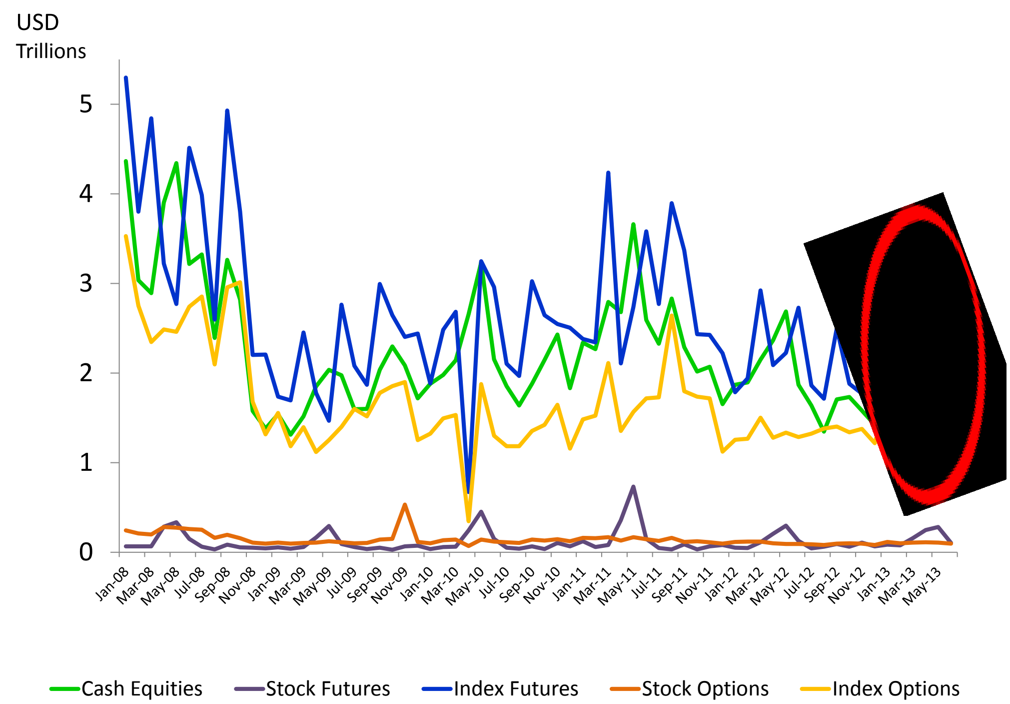
Source: TABB Group

-52%

Equity derivative volumes down 52% since 2008 versus a 43% decline for cash equities

European futures and options volumes were up by 9.5% to €1.13 billion in the first quarter, but declined in Q2 2013

Equity and Equity Derivatives Volume by Instrument Type (2008 – June 2013)



Source: TABB Group

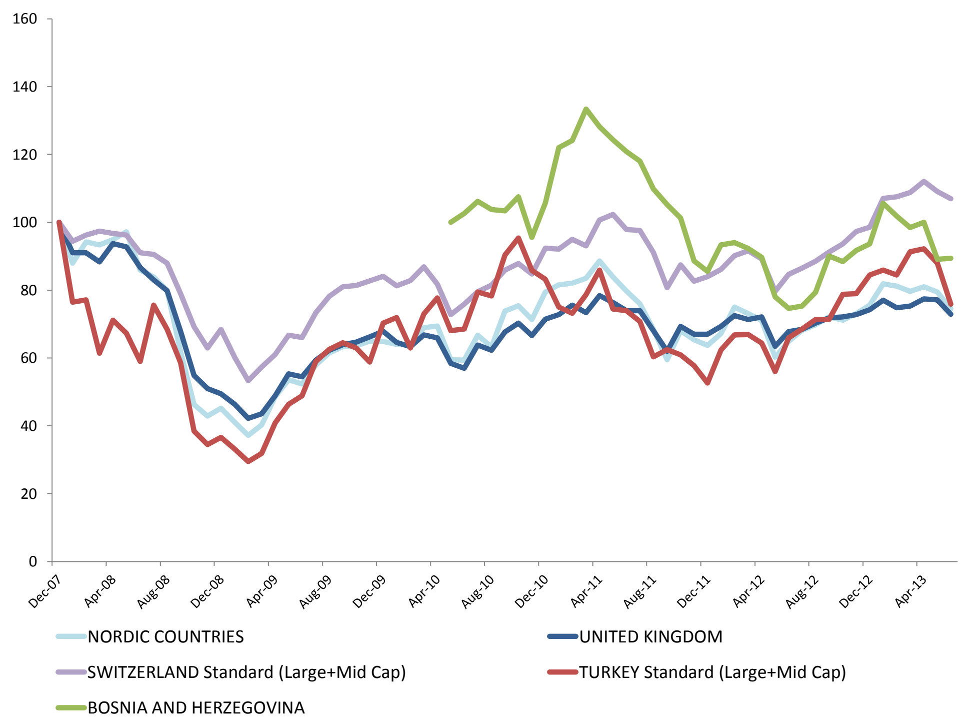
There has still been no wholesale shift in derivatives volumes but this, as with everything else in Europe, will hinge on the final outcome of the latest regulation. With long-only asset managers heavily dependent on dark pools to execute their order flow, and the reduction in both HFT and electronic market making, there is every reason to anticipate a further shift away from cash equity trading to synthetics as we have already witnessed in France.

Talking Turkey

In the first week of July 2013, developed market equity funds took in $15.7 billion in new flows, vs $2 billion of outflows in emerging funds

Turkey is losing favour, with developed markets – Switzerland, the UK and Nordics – now competing with European frontier markets for performance

MSCI Top European Performance by Country (2007-2013 H1)



Source: TABB Group / MSCI

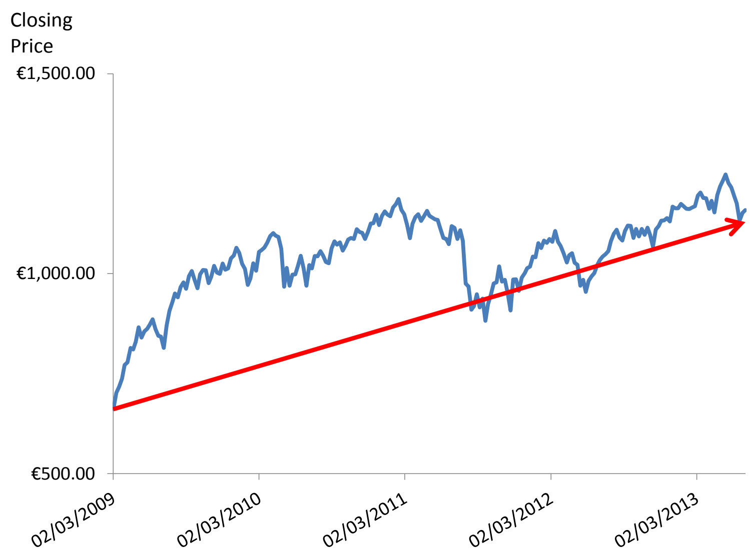
In the hunt for performance, emerging markets are losing their lustre. The top-performing European indices include three developed nations – Switzerland, the Nordics and the UK – as well as the frontier markets of Bosnia-Herzegovina, Lithuania and Estonia, and only one emerging market, Turkey. Hit by political unrest, the MSCI performance rating for Turkey has fallen 18% from its peak in April 2013.

+18%

FTSEurofirst 300 Index is up over 18% H1 2013 vs 2012, hitting a 52-week high in May 2013

European monthly volume turnover increased 32% in January. Volumes continued to rise, before declining 22% in June and stabilising in July

FTSEurofirst 300 Index Closing Price (2009-2013 H1)



Source: TABB Group / FTSEurofirst 300

UK growth forecasts have been moving upwards, with the economy growing 0.6% in the second quarter of 2013[4], twice as fast as the previous quarter. UK business confidence is at a six-year high[5], with projections that the UK economy will grow 1.2% this year and 1.8%

[4] http://www.ons.gov.uk/ons/rel/gva/gross-domestic-product--preliminary-estimate/q2-2013/stb-gdp-preliminary-estimate--q2-2013.html
[5] British Chambers of Commerce (BCC)

in 2014.[6] Inflation numbers were lower than expected and a raft of indicators are turning positive amid continuing signs that a long-awaited thaw in frozen business confidence is beginning to take place.

German business morale also remained in positive territory during July for the third consecutive month despite a worsening global outlook and diminished appetite for manufacturing. German industrials in particular remain under pressure from the downturn in new markets such as China and Brazil.[7] Yet the domestic picture is improving and the IFO business climate index[8] rose to 106.2 in July from 105.9 in June.[9]

Economic confidence in the 17-nation Eurozone rose in July, reaching the highest point since April last year. The European Commission's monthly measurement of sentiment among consumers and businesses rose to 92.5 from 91.3 in June. Morale is finally improving, retail sales rising and overall joblessness falling, while the Purchasing Managers' Index rose above 50 for the first time to an 18-month high of 50.4.[10]

Yet it is clear that this is not the prognosis for the wider Eurozone, and there is increasing, and alarming, divergence within these nation states.

Of particular concern is France, which has now fallen into a triple-dip recession, with gross domestic product falling 0.2%.[11] The economy is at risk of being pushed into outright deflation next year, versus Germany and Belgium's increase into positive territory. From January 1999 to April 2013, French production decreased by 11.4%, while German production increased by 32%. French profitability is perceived to be so low that there is no incentive to invest. The International Monetary Fund (IMF) estimates the French economy will continue to lose market share "both globally and relative to peers", with the unemployment rate set to rise further to 11.6% in 2014, in contrast to president Hollande's predictions to reduce the rate to below 10.6% within five years.[12]

Those on the periphery will continue to face the wrath of austerity for several years to come. The recession in Spain, the Eurozone's fourth largest economy, may appear to be easing[13], with the Spanish economy contracting at a slower rate, albeit for the eighth quarter in a row. However, the likelihood is this is only a temporary measure due to the recent success of its tourism industry, in part due to Northern Europeans shunning holiday destinations such as Turkey, Egypt and Cyprus on the back of political instability. The country's gross domestic product contracted 0.1% between April and June versus a

[6] National Institute of Economic and Social Research, August 2013
[7] http://www.ft.com/cms/s/0/4162aaa2-fe63-11e2-b9b0-00144feabdc0.html#axzz2az0u2k2p
[8] http://www.cesifo-group.de/ifoHome.html
[9] Ifo think-tank, July 2013
[10] Markit Economics 2013
[11] Eurostat 2013
[12] http://www.telegraph.co.uk/finance/financialcrisis/10224099/IMF-sees-no-end-to-French-jobless-crisis-this-decade.html
[13] National Statistics Institute, Madrid, July 2013

contraction of 0.8% in Q4 2012.[14] In September, the situation in Spain is expected to reverse and recent research from the IMF concurs: Spain will be stuck with an unemployment rate above 25% for at least five more years[15], one of the highest levels in the industrialised world. Despite the country being on track to emerge from recession, the 6 million unemployed are unlikely to benefit. Future growth rates will be too minimal to facilitate job creation, not reaching more than 1% until 2018 and underlining the continuing challenges for European politicians to rebalance diverging economies.

Greek youth unemployment has now reached 64.9% and the economy is expected to contract by a further 5% in 2013.[16] Austerity alone to cut the budget deficit has proved self-defeating as the scale of economic contraction overwhelms any positive gains. Brazil has called for IMF-backed rescue programmes for southern Eurozone countries to be reviewed and made more economically sustainable. The representative for Brazil on the IMF's executive board abstained in a vote to authorise the latest payment to Greece and delivered a stern rebuke of the bailout programme.

The backlash against austerity continues to gain ground, with the Calvinistic Dutch once staunch supporters of austerity also switching approach. Dutch unions are attempting to block
€6 billion in austerity measures the government needs to put in place by 2013 to keep the budget deficit under the 3% limit imposed by the EU bailout fund.[17]

Any split over the response to the Eurozone crisis is at risk of widening the €11 billion shortfall for the bailout fund, which needs to be partially filled by the end of 2013. The IMF is looking for nations to pay a further 4% of economic output – or about €7.4 billion – over the next two years, which will be difficult to achieve in the current economic climate.[18]

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[14] Bank of Spain, July 2013
[15] IMF, August 2013

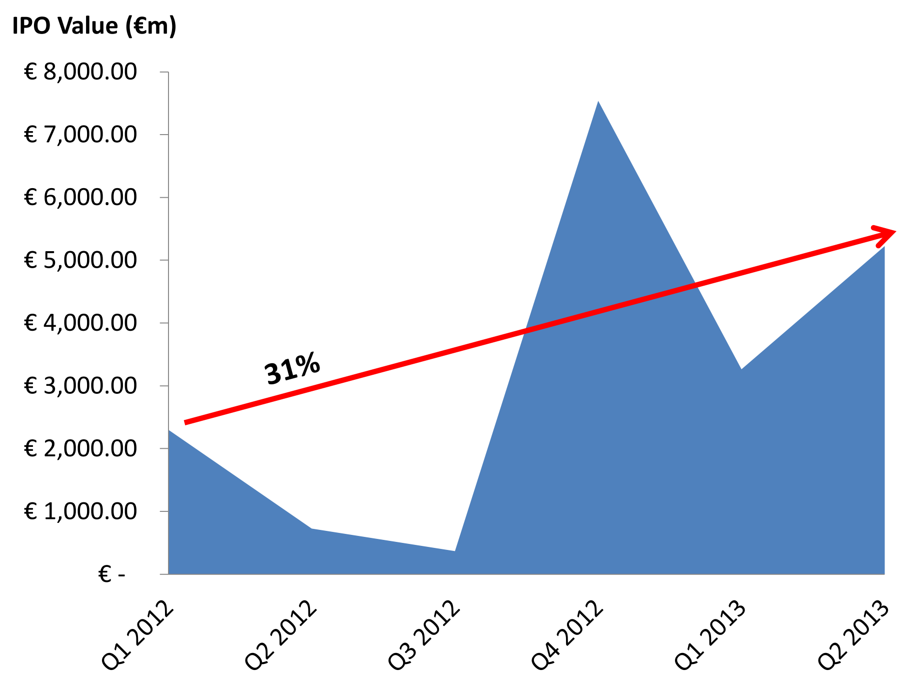
[16] http://euobserver.com/tickers/121078
[17] http://www.ft.com/intl/cms/s/0/e0cef102-0040-11e3-9c40-00144feab7de.html?ftcamp=crm/email/201389/nbe/BrusselsBrief/product#axzz2az0u2k2p
[18] http://www.ft.com/intl/cms/s/0/36a7460a-000b-11e3-9c40-00144feab7de.html?ftcamp=crm/email/201389/nbe/BrusselsBrief/product#axzz2az0u2k2p

31%

The European IPO market resumes its recovery, raising €5,225 million in Q2 2013

European stock exchanges raised $2 billion from 27 IPOs, accounting for 6% of global issuances

IPO Activity in Europe 2012 – 2013 H1



Source: TABB Group / PWC

The Final Word in Politics

Draghi's promise a year ago that the European Central Bank (ECB) would do "whatever it takes" to save the euro proved to be a critical turning point in Europe's sovereign debt crisis. Without the ECB buying a single bond, European market-borrowing costs are a far cry from 2012, when levels threatened the sustainability of public finances and disintegration of the European Union. The success of the ECB's outright monetary transactions programme was further illustrated by the fact that while Portugal suffered a recent rise in borrowing costs, Lisbon's yields rose in isolation rather than creating the domino effect seen in 2012.

Yet the Eurozone is hardly an oasis of political stability: the growing divergence between north and south is not only intensifying, but the number of countries falling into the periphery is on the rise. French politics remains fraught with the recent outbreak of rioting in response to the controversial burka law, together with further union protests over pension reform expected in autumn.[19] After a series of by-election defeats, the Socialist party's majority in the national assembly has been cut to just five seats, forcing Hollande's precarious juggling act between left and right. Recent dire economic predictions by the IMF will not aid his position and Hollande will struggle to maintain control.

In Italy, Berlusconi's recent conviction for tax fraud by the Italian Supreme Court also has the potential to break the current fragile coalition. Enrico Letta's government depends upon the support of Berlusconi's centre-right People of Freedom party. Although Berlusconi will be under house arrest, the judges upheld a ban on Berlusconi holding public office via an anti-corruption law passed by Mario Monti's previous government. Under this law, Berlusconi cannot run for election for at least six years and could potentially lose his seat in the senate. Berlusconi loyalists have warned that should the government vote in favour of his ejection from the senate, the coalition will fall. Marina Berlusconi, the 46-year-old chairwoman of the family holding company, Fininvest, and eldest of Berlusconi's five children, is widely predicted to be his political heiress when the party relaunches itself under its original name of Forza Italia
(Go Italy).

The Spanish government also remains under siege. Prime minister Rajoy is battered but in charge despite the recent publication of alleged documents citing illegal payments of funds. Bond markets and foreign investors have so far taken a relatively sanguine view of the affair, apparently convinced that Spain is unlikely to face the kind of political instability that has racked Italy and Portugal this year. A recent sale of three- and five-year bonds, which

[19] http://www.ft.com/intl/cms/s/0/2b076bcc-f395-11e2-942f-00144feabdc0.html#axzz2Zx6iuS95

raised €3.22 billion at markedly lower yields than in previous auctions, means that Spain has now raised more than three-quarters of its financing needs for the entire year.[20]

Similarly, the fragile Portuguese coalition government is steadfastly hanging on to see through the country's €78 billion EU bailout programme, despite the resignation of two senior ministers in early July and the subsequent collapse of recent talks on a "national salvation" pact with the main opposition party.

The other factor to watch in the second half of 2013 will be the outcome of the German election in September. Angela Merkel was previously considered a "shoo-in". However, as revelations intensify regarding collaboration between German and US intelligence agencies in the wake of the Snowden affair, Merkel herself is coming under increasing scrutiny. Yet just weeks ahead of the elections, Merkel's coalition government is gaining ground, scoring 49% support.[21] Merkel is particularly popular, with 60% saying they would like to see her as chancellor again.

While individual political crises are no longer blowing up into the systemic threats that previously sent financial markets reeling, Europe's deep-seated structural and debt problems remain. The recovery story is a fragile one limited to a handful of northern European countries rather than the wider region.

Increasing and conflicting regulation will continue to impact financial services, with only a handful of global investment banks surviving at their current size. We anticipated further restructuring in the short to medium term, with firms focusing on core strengths at the start of the year, and a raft of investment banking results has confirmed this. Second-tier firms will continue to struggle unless they can create a unique foothold in either research or execution.

One great unknown remains – the impact of the EU-11 financial transaction tax. The reaction of market participants in both Italy and France, where FTTs have been in place for some time, has delivered significant structural changes in investment strategies as well as execution. A 25% downturn in volumes will eventually affect primary markets, as well as damaging equity turnover in the short-term. Although revenues have yet to be collected in Italy, the mere €200 million collected in France is an insignificant gain versus the detrimental impact at a critical junction in the country's economic fortunes.

Europe remains at a crossroads. The tide may slowly be turning in Europe, but regulation remains **the** key factor in any European recovery.

[20] http://www.tesoro.es/en/index.asp
[21] DeutschlandTrend

The tide is turning

The future for European equities lies in the hands of the regulators. Regardless of any positive momentum, we are still reliant on the final outcome of the latest legislation, in particular MiFID II, which is due to be completed in trialogue by the end of this year.

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www.tabbgroup.com

New York
+ 1.646.722.7800

London
+ 44 (0) 203 207 9027

Westborough, MA
+ 1.508.836.2031