

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

EUROPEAN EQUITY FUND, INC / MD
Form N-CSR
March 10, 2006
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM N-CSR

Investment Company Act file number 811-04632

THE EUROPEAN EQUITY FUND, INC.

(FORMERLY THE GERMANY FUND, INC.)

(Exact Name of Registrant as Specified in Charter)

343 Park Avenue, New York, NY 10154

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (212) 454-7190

Paul Schubert

345 Park Avenue

New York, NY 10154

(Name and Address of Agent for Service)

Date of fiscal year end: 12/31

Date of reporting period: 12/31/05

ITEM 1. REPORT TO STOCKHOLDERS

SUMMARY OF GENERAL INFORMATION

THE FUND

The European Equity Fund, Inc. is a non-diversified, actively-managed Closed-End Fund listed on the New York Stock Exchange with the symbol *EEA*. The Fund seeks long-term capital appreciation primarily through investment in European equities. It is managed and advised by wholly-owned subsidiaries of the Deutsche Bank Group.

SHAREHOLDER INFORMATION

Prices for the Fund's shares are published daily in the New York Stock Exchange Composite Transactions section of newspapers. Net asset value and market price information are published each Monday in *The Wall Street Journal* and *The New York Times*, and each Saturday in *Barron's* and other newspapers in a table called "Closed End Funds". Daily information on the Fund's net asset value is available from NASDAQ (symbol XEEAX). It is also available by calling: 1-800-GERMANY (in the U.S.) or 617-443-6918 (outside of the U.S.). In addition, a schedule of the Fund's largest holdings, dividend data and general shareholder information may be obtained by calling these numbers.

The foregoing information is also available on our Web site: www.germanyfund.com.

There are three Closed-End Funds investing in European equities managed by wholly-owned subsidiaries of the Deutsche Bank Group:

The European Equity Fund, Inc. investing primarily in equity or equity-linked securities of companies domiciled in European countries that utilize the Euro currency.

The New Germany Fund, Inc. investing primarily in the middle market German companies and up to 20% elsewhere in Western Europe (with no more than 10% in any single country).

The Central Europe and Russia Fund, Inc. investing primarily in Central European and Russian companies.

Please consult your broker for advice on any of the above or call 1-800-GERMANY (in the U.S.) or 617-443-6918 (outside of the U.S.) for shareholder reports.

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

These funds are not diversified and focus their investments in certain geographical regions, thereby increasing their vulnerability to developments in that region. Investing in foreign securities presents certain unique risks not associated with domestic investments, such as currency fluctuation, political and economic changes, and market risks. This may result in greater share price volatility.

[Graphic Appears Here]

The European Equity Fund, Inc.

Annual Report

December 31, 2005

20957

The European Equity Fund, Inc.

LETTER TO THE SHAREHOLDERS

European equities posted double-digit returns for the third year in 2005, where markets were boosted by revitalized confidence in economic growth, subsiding inflation fears and increased risk appetite. Although equity markets in Europe and much of the rest of the world dipped lower at the beginning of the fourth quarter, due to concerns of slowing growth and rising inflation, they bounced back in November and December to register strong gains for the year in many regions. On the economic front, the German ZEW Index, which measures economic expectations, had its largest one-month uptick in more than a decade while the Ifo Index, which measures the business climate, reached its highest level in five years. The European Central Bank raised rates for the first time in two and a half years, to 2.25%, while the US Federal Reserve raised rates twice during the fourth quarter, ending at 4.25%. The US dollar strengthened significantly against the euro in 2005. Oil prices ended the year 40% higher, while the top-performing commodity of the year, natural gas, gained 83% for the 12-month period.

For the fiscal year 2005, the The European Equity Fund's total return increased 7.17% based on net asset value and 9.66% based on share price.

During the same period, the Fund's benchmark gained 8.41%.* During the fourth quarter, as approved in a special shareholder meeting held October 27, 2005, the fund changed its investment objective to allow for an enlarged European investment universe, which lends itself to greater diversification across countries and sectors, including key sectors, such as energy, that were underrepresented in the DAX. We continue, though, to view Germany, where corporate restructuring combines with compelling valuation, as an attractive market. In the two months since the Fund transitioned to its new European investment universe, relative

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

performance of the Fund mainly benefited from its stance on Germany, industrial stocks and telecoms while our holdings in health care and technology detracted from performance. Overall, the MSCI EMU advanced 2.2% during the fourth quarter. Financials, industrials, and materials were the best-performing sectors in the market, while telecoms and energy were the only sectors to show negative returns in the fourth quarter. The Netherlands and Germany delivered the best performance of the larger markets, while Spain, Italy, and France underperformed. Outside the EMU, Switzerland (the Fund's largest non-EMU investment) was strongest, rising nearly 10%.

The fund's stock selection during the fourth quarter was guided by the application of several key strategic themes. For example, the fund prefers industrial spending over consumer spending. Underinvestment in the past in many industries, particularly in utilities, transport, energy and mining, has created significant pent-up demand for industrial goods and services as well as technology applications. As companies are underleveraged and continue to generate healthy cash flow, they have increased capital expenditures in an effort to grow sales. On the other hand, consumer spending is either extended (in the United States and UK, for example) and unlikely to rise further or held back by structural issues, as in Germany and Italy. Two of the fund's key positions within industrials are Siemens and ABB for their restructuring potential and exposure to the investment demand from utilities, particularly in Asia.

The buoyant economic growth globally, and in China in particular, keeps demand for oil at a high level while supply remains tight. Therefore, oil prices seem bound to stay higher for longer, the implications of which the fund believes is not yet fully reflected in the energy stocks' valuations. Within the energy sector, the fund believes the oil services stocks benefit from the oil majors' expansion in capital expenditures to increase oil production. Meanwhile, valuations of the oil producers still discount a significant decline in the oil price from current levels.

The Fund purchased 183,700 of its shares in the open market during 2005. During the fourth quarter, in connection with the change in investment objective, the fund conducted a tender offer in which shareholders tendered 2,957,998 shares at 95% of net asset value. For the year ending December 31, 2005, the fund's discount to net asset value averaged 11.42% compared with 12.43% for the previous fiscal year.

The sources, opinions and forecasts expressed are as of January, 2006. There is no guarantee that the views, opinions and forecasts expressed herein will come to pass. This information is subject to change at any time based on market and other conditions and should not be construed as a recommendation for any specific security. Past performance does not guarantee future results.

¹ DAX Index is a total rate of return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange.

* As of November 1, 2005, the benchmark is the MSCI EMU Index. Prior to November 1, 2005, the benchmark was the DAX Index.

Sincerely,

/s/Christian Strenger
Christian Strenger
Chairman

/s/Vincent J. Esposito
Vincent J. Esposito
President and Chief Executive Officer

For additional information about the Fund including performance, dividends, presentations, press releases, daily NAV and shareholder reports, please visit www.germanyfund.com

1

FUND HISTORY AS OF DECEMBER 31, 2005

All performance shown is historical, assumes reinvestment of all dividend and capital gain distributions, and does not guarantee future results. Investment return and principal value fluctuate with changing market conditions so that, when sold, shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit www.germanyfund.com for the Fund's most recent performance.

TOTAL RETURNS:

	For the years ended December 31,							
	2005		2004		2003		2002	
Net Asset Value ^(a)	7.17	%	12.58	%	59.62	%	(34.43)%
Market Value ^(a)	9.66	%	7.25	%	68.81	%	(35.76)%
Benchmark	8.41 ⁽¹⁾	% ⁽¹⁾	15.91 ⁽¹⁾	% ⁽²⁾	65.16 ⁽¹⁾	% ⁽²⁾	(34.14 ⁽¹⁾)% ⁽²⁾

(a) Total return based on net asset value reflects changes in the Fund's net asset value during each period. Total return based on market value reflects changes in market value. Each figure includes reinvestments of dividend and capital gain distributions, if any. These figures will differ depending upon the level of any discount from or premium to net asset value at which the Fund's shares trade during the period.

(1) Represents DAX Index* for 1/1/05 - 10/31/05 and MSCI-EMU** for 11/1/05 - 12/31/05.

(2) Represents DAX Index*.

* DAX Index is a total rate of return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange.

** MSCI-EMU Index is an unmanaged capitalization-weighted index that as of June 30, 2005 comprised of 319 stocks of companies domiciled in the

12 countries utilizing the Euro currency.

Index returns assume reinvested dividends and, unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly into an index.

On October 27, 2005, the Fund adopted its current name and investment policies. Prior to that date the Fund was known as The Germany Fund and its objective was to seek long-term capital appreciation primarily through investments in German equities.

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

Investments in funds involve risk including the loss of principal.

This Fund is not diversified and primarily focuses its investments in equity securities of issuers domiciled in European countries that utilize the Euro currency, thereby increasing its vulnerability to developments in that region. Investing in foreign securities presents certain unique risks not associated with domestic investments, such as currency fluctuation and political and economic changes and market risks. This may result in greater share price volatility.

Closed-end funds, unlike open-end funds, are not continuously offered. There is a one-time public offering, and once issued, shares of closed-end funds are sold in the open market through a stock exchange. Shares of closed-end funds frequently trade at a discount to net asset value. The price of the Fund's shares is determined by a number of factors, several of which are beyond the control of the Fund. Therefore, the Fund cannot predict whether its shares will trade at, below or above net asset value.

The Fund has elected to not be subject to the statutory calculation, notification and publication requirements of the German Investment Tax Act (Investmentsteuergesetz). As a result German investors in the Fund may be subject to less favorable lump-sum taxation under German law.

2

FUND HISTORY AS OF DECEMBER 31, 2005 (continued)

STATISTICS:

Net Assets	\$ 117,700,424
Shares Outstanding	11,831,994
NAV Per Share	\$ 9.95

DIVIDEND AND CAPITAL GAIN DISTRIBUTIONS:

<u>Record Date</u>	<u>Payable Date</u>	<u>Ordinary Income</u>	<u>LT Capital Gains</u>	<u>Total</u>
12/22/05	12/30/05	\$ 0.060	\$	\$ 0.060
12/22/04	12/31/04	\$ 0.025	\$	\$ 0.025
05/06/04	05/14/04	\$ 0.039	\$	\$ 0.039

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

11/19/02	11/29/02	\$ 0.010	\$	\$ 0.010
11/19/01	11/29/01	\$ 0.060	\$	\$ 0.060
09/03/01	09/17/01		\$ 0.020	\$ 0.020
11/20/00	11/29/00		\$ 2.180	\$ 2.180
09/01/00	09/15/00	\$ 0.190	\$ 0.120	\$ 0.310

OTHER INFORMATION:

NYSE Ticker Symbol	EEA	
NASDAQ Symbol	XEEAX	
Dividend Reinvestment Plan	Yes	
Voluntary Cash Purchase Program	Yes	
Annual Expense Ratio (12/31/05)*	1.74	%

*Represents expense ratio before custody credits. Please see Financial Highlights section of this report.

3

PORTFOLIO BY MARKET SECTOR AS OF DECEMBER 31, 2005 (As a % of Portfolio's Market Value*)

ORIGINAL DOCUMENT CONTAINS PIE CHART HERE

PIE CHART DATA:

Consumer Staples (1.9%)	Energy (12.1%)	
Consumer Discretionary (9.0%)		Financials (32.8%)
Materials (3.5%)		
Utilities (3.7%)		
Telecommunication Services (3.6%)		Health Care (4.7%)
Information Technology (8.8%)		
	Industrials (19.9%)	

10 LARGEST EQUITY HOLDINGS AS OF DECEMBER 31, 2005 (As a % of Portfolio's Market Value*)

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

1	.	Total	6.4
2	.	Siemens	5.2
3	.	DaimlerChrysler	3.7
4	.	Banca Intesa Spa	3.7
5	.	E.ON	3.7
6	.	SAP	3.4
7	.	Capitalia Spa	3.2
8	.	Adidas Salomon	3.0
9	.	Hypo Real Estate Holding	2.8
10	.	Banco Bilbao Vizcaya Argentaria	2.6

* Percentage (%) of market value refers to all securities in the portfolio, except cash and equivalents. Portfolio by Market Sector and 10 Largest Equity Holdings are subject to change.

Following the Fund's fiscal first and third quarter-end, a complete portfolio holdings listing is filed with the SEC on Form N-Q. The form will be available on the SEC's Web site at www.sec.gov, and it also may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information on the operation of the SEC's Public Reference Room may be obtained by calling (800) SEC-0330.

4

INTERVIEW WITH THE CHIEF INVESTMENT OFFICER

Question: In the fourth quarter of 2005, The Germany Fund's shareholders voted in favor of changing the fund's name to The European Equity Fund, as well as changing the fund's investment objective. Has the transition and tender offer been completed?

Answer: The fund has successfully completed all aspects of the transition. The fund's ticker symbol was changed to EEA, and the benchmark was changed from the DAX to the MSCI EMU. A minimum 80% of the fund's assets must now be invested in the Euroland countries of Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. The remaining 20% of the fund's assets may be invested in European countries that do not utilize the euro currency. The new investment universe has not only resulted in a geographically more diversified fund, but it has also resulted in greater diversification across sectors. For example, the energy sector was not represented at all in the Fund's previous benchmark, but this sector has an 8% weighting in the MSCI EMU. In addition to transitioning the portfolio holdings, the Fund completed a tender offer, which resulted in a payment to tendering shareholders of approximately \$27 million.

Question: Given the Fund's new benchmark, how will European Union expansion affect the Fund?

Answer: One of the unique features of the fund's new investment universe is its natural expansion as additional countries enter the EMU. Currently, 10 European Union (EU) countries are working toward membership in the EMU. These countries are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. As these countries join the EMU over the next several years, they will become part of the fund's core investment universe.

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

Question: You mentioned the increased importance of the energy sector under the Fund's new investment objective. There has recently been increased focus on supply to Europe, following the decision of Russian gas company Gazprom to disrupt supply in connection with a price dispute. Will you comment on the impact of recent events and the future stability of Europe's energy supply?

Answer: Russia supplies approximately 25% of Europe's gas. That supply was disrupted in January as a result of a dispute between Gazprom and Ukraine regarding the price that Ukraine should pay. Ukraine has historically received Russian gas substantially below market price. The dispute ended when Ukraine agreed to a higher price for Gazprom that is still favorable to the Ukraine. Nevertheless this experience is likely to result in further efforts to develop a coherent energy policy that includes reduced dependence on Russian supply. European leaders might also need additional assurances from Russia when it comes to supplying natural resources.

Question: What are the key issues facing the European equity markets in 2006?

Answer: We expect to see continued divergence at the country level, increased M&A activity and a pickup in investment spending. As the performance of multinational companies becomes increasingly independent of local economies or politics, moderate global economic growth overall and limited inflationary threats provide a benign backdrop for healthy corporate margins and cash flows. The key risk we see lies in aggressive monetary tightening driven by exaggerated inflationary concerns. However, even if financial markets may be volatile in response to such central bank action, we continue to believe that European equities maintain solid earnings growth and attractive valuation, particularly vs. many other asset classes. Given the earnings growth achieved in 2005 and expected for 2006, equity markets have not experienced much in terms of valuation expansion, thus leaving room for further upside in 2006.

Sandra M. Schaufler, Chief Investment Officer of The European Equity Fund, Inc.

5

REPORT FROM THE INVESTMENT ADVISER AND MANAGER

The European Equity Fund - Economic Outlook

The remarkable resilience of macroeconomic data from the major world economies, particularly the United States, as well as companies reporting earnings above expectations helped sustain equity markets throughout 2005. We see this as confirmation of our view that the global economy is in good shape, with moderate economic growth overall and limited inflationary threats. We believe the global macroeconomic environment is favourable for European equities.

Consumer confidence indicators surprised on the upside at the end of 2005, in part due to a moderate decline in unemployment. Nonetheless, private consumption is expected to remain sluggish in 2006, given that real wage growth remains modest. The 3% VAT hike scheduled to go into effect January 2007 may provide an

Edgar Filing: EUROPEAN EQUITY FUND, INC / MD - Form N-CSR

artificial boost to consumption in 2006 as purchases are brought forward to avoid the increased tax rate. However, given the expected sluggishness in consumer spending, net exports should continue to drive Euroland growth in 2006, though considerable divergence has been observed at the country level. Italy, for example, has suffered from stagnating exports over the past five years (while German exports have grown 25%) and is expected to lag the rest of Euroland in 2006. Capital spending increased 1.6% in the third quarter of 2005 and may pick up further as increased confidence convinces cash-rich companies to invest. This is further supported by data showing that German manufacturing orders have soared due to strong external demand.

As 2005 came to a close, headline inflation registered at 2.2% while core inflation remained steady at 1.4%. In 2006, we are assuming inflation is likely to stay above the European Central Bank's (ECB) 2% target due to the impact of higher energy prices, though the core rate should remain contained. As with growth, considerable divergence has been recorded within the European Monetary Union, with consumer prices in Italy, for example, rising much faster than in Germany.

In its first two meetings of the year, the ECB kept interest rates unchanged at 2.25%. We believe that the ECB is likely to raise rates by another 0.50% in the first half of 2006, with the next move likely to be a 0.25% hike in March. However, any signs of weakness in the economic indicators could cause the ECB to refrain from further rate hikes. A stabilizing interest rate differential with the United States should be supportive of the euro.

Special Considerations

The observations in this letter reflect our own opinions as of January, 2006 and are based on our own analysis, and others may have different opinions. Events may not transpire as we or they currently expect. Also, while economic events can influence broad market trends, political, monetary and other factors are also relevant to stock performance. In any event, investment results will depend on our success in identifying individual stocks, which are influenced by many factors beyond general economic matters. We cannot predict investment results or whether they will be successful.

6

DIRECTORS OF THE FUND

Name, Address and Age*	Principal Occupation(s) During Past Five Years	Other Directorships Held by Director
Detlef Bierbaum, 63 ⁽¹⁾⁽²⁾ Class I	Partner, Sal. Oppenheim Jr. & Cie KGaA (investment management).	Director, The Central Europe and Russia Fund, Inc. (since 1986). Member, Supervisory Board, Tertia Handelsbeteiligungsgesellschaft mbH (electronic retailer). Member, Supervisory Board, Douglas AG (retailer). Member, Supervisory Board, LVM Landwirtschaftlicher Versicherungsverein (insurance). Member, Supervisory Board, Monega KAG. Member, Supervisory Board, AXA Investment Managers GmbH (Investment Company). Chairman, Supervisory Board, Oppenheim Kapitalanlagegesellschaft mbH (invest-

ment company). Chairman, Supervisory Board, Oppenheim Real Estate Investment GmbH. Member, Supervisory Board, Cologne Reinsurance AG. Chairman, Administrative Board, Oppenheim Prumerica Asset Management S.a.r.l. (investment company). Member, Supervisory Board, Atradius N.V. (insurance company). Member, Supervisory Board of DWS Investment GmbH. Member, Board of Quindee REIT, Toronto.

7

DIRECTORS OF THE FUND (continued)

Name, Address and Age*	Principal Occupation(s) During Past Five Years	Other Directorships Held by Director
-------------------------------	---	---