



Outlook & Commentary

Are European equities overlooked?

Joerg de Vries-Hippen | 06/09/2018



Summary

Europe can't compete with the high-flying US tech sector, but perhaps that isn't a bad thing. Europe is a region with decent growth, strong macroeconomic data and many healthy companies trading at a discount – which makes the market's worries appear overdone.

Key takeaways

- Unlike the US market, which is dominated by tech, Europe has more “old” businesses such as industrials or financials – and Europe is attractively priced
- What's to love about Europe? GDP growth remains above-potential at 2%, and unemployment keeps declining: the latest euro-zone numbers are the lowest since December 2008
- As an active asset manager, we've uncovered many European firms that are financially sound, have full order books and even complain about a lack of capacity
- Consider a dividend-focused, value-based approach to Europe: financials and energy look attractive

European equity indices once again started to lag their US counterparts over the course of the summer, and investors have been steadily moving away from Europe for most of the year. Yet Europe is a region with solid growth, strong macroeconomic data and many healthy companies trading at a discount – which, in our view, makes worries about Europe appear overdone.

Recently, investors have preferred the US over Europe in large part because of the high-flying dominance of the US tech sector. Tech constituted more than 25% of the overall US market on 12 June, according to Bank of America Merrill Lynch, while the euro-zone market had a tech component of just under 10%. Europe has more balanced sector exposure, with the largest representation by “old” business such as industrials or financials.

But this is not necessarily a bad thing, particularly considering what happened during periods of excess sector concentration in the past – including the tech sector during the dot-com bubble, financials during the 2006 housing bubble and energy back in the 1970s.

Moreover, some portfolio manager surveys show that the most overbought area of the market is US tech, while European financials are among the most oversold. So while Brexit continues to

weigh on investors' minds, it may be time to take another look at Europe.

Europe shouldn't be so unloved

Investors generally have an extremely poor view of Europe. Its equity markets recently registered their 24th consecutive week of outflows, effectively removing all inflows seen over the course of 2017.

However, although second-quarter economic growth hit a soft patch, primarily due to France and Italy, euro-zone GDP growth is expected to remain above-potential at around 2% this year. This should support local stock markets. In addition, the latest batch of macroeconomic data out of Europe contains many highlights:

- Industrial production and export activity have recovered from temporary low points.
- GDP growth in the UK recovered in the second quarter, supported by construction and industrial production.
- Unemployment continues to decline in the euro zone; the latest numbers are the lowest since December 2008.
- Overall employment is at a record high and wage growth has picked up notably; labour shortages can even be felt in the more buoyant countries, such as Germany.

Despite a temporary GDP slowdown, unemployment is falling



Source: Eurostat, AllianzGI Global Economics & Strategy. Data as at 31/7/2018.

As a result, household consumption in the euro zone – which accounts for well above 50% of GDP – is set to remain a key driver of Europe's ongoing solid economic performance. Strong domestic demand has also shielded Europe from the impact of trade tensions so far.

An active approach to investing in Europe

Because Europe is a very open economy, the region and its stock markets get hit hard when investors worry about global trade or emerging-market issues. Yet some of the concerns around these issues appear overdone, with the market frequently deciding to shoot first and ask questions later. The Brexit vote on 23 June 2016 was a good example of this. After the initial panic and strong volatility, markets returned to focusing on the fundamentals, which were supportive. In fact, European markets have moved up more than 25% since the initial post-vote turmoil.

As an active asset manager, we focus on the fundamental facts. Panic moments often lead to mistakes, costing real money. We take a more considered approach, starting with frequent interactions with European companies. We've discovered numerous firms that are financially sound, have full order books and have even started to complain about a lack of capacity.



This leads us to emphasise a dividend-focused, value-based approach to European equities. Yields in Europe are high, confirming the discount applied to European stocks. In our view, there is an undue neglect of companies with well-supported dividend payments. Moreover, modestly rising interest rates and a continued, gentle economic expansion make the value side of Europe appealing. Such an environment typically translates into better earnings – for example, for financials, many of which are strong dividend-payers. In addition, ongoing restructuring efforts by European energy companies can translate into strong cash generation and dividends.

While large parts of the global stock markets trade on elevated valuations despite recent volatility, we believe Europe remains attractively priced. Investors should of course be prepared for even more noise and volatility in the run-up to the mid-term elections in the US. But buying good European companies at good prices may be able to shield investors from some of this impact. In a world driven by high-tech flash, consider using Europe's "substance and value" to balance an otherwise growth- and tech-biased portfolio.

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Outlook & Commentary



A confident ECB wants to keep its options open

Franck Dixmier | 11/09/2018



Summary

We don't expect much news from the communications surrounding the European Central Bank's next meeting. But we do expect them to balance expressions of confidence in the euro-zone economy with a cautious approach to rate hikes.

Key takeaways

- The euro zone's economic environment is still robust and its growth outlook still strong – which should give the ECB confidence to end QE this year
- At its next meeting, the ECB probably won't commit to raising rates before summer 2019; policymakers want to keep an eye on upcoming data – particularly inflation
- Don't expect the ECB to discuss Italy or reinvesting QE proceeds; officials would rather keep their options open in today's tense geopolitical environment

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