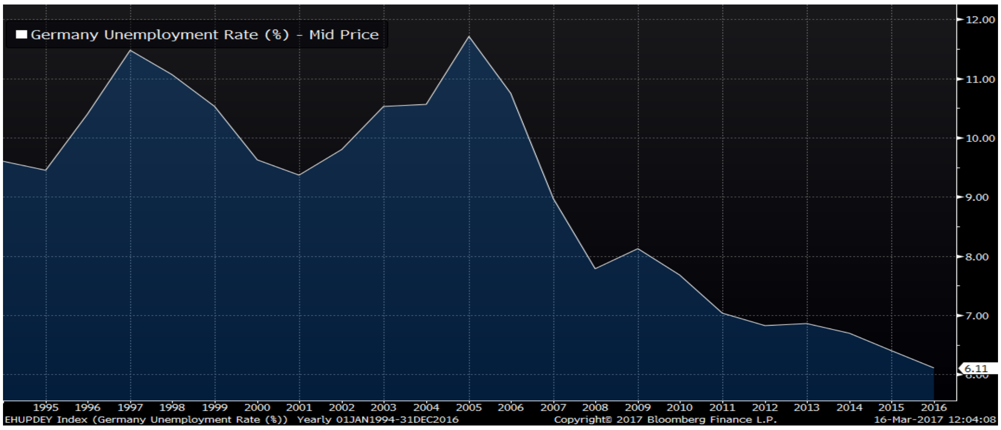
A BULL CASE FOR EUROPE

Stephen Roberts
Market Views

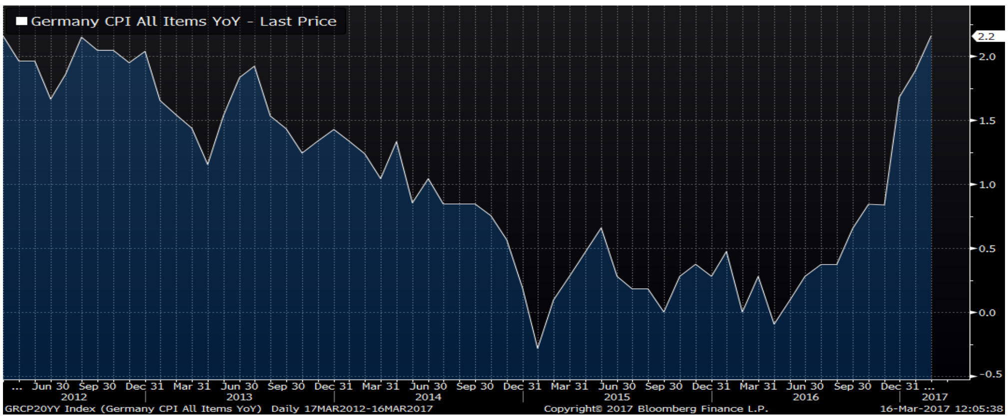
"While investors are currently concerned about the possibility of Marine Le Pen coming into power, profit growth at European companies in the last quarter quietly outperformed the US for the first time in eighteen months. Despite this, the STOXX 600 currently trades at 15x Forward EPS, which compares to nearly 18x for the S&P 500."

Ever since I started investing in Europe, it has been difficult to build a bull case for its domestic economies. European decision makers have been slow in pushing through reforms and the political backdrop has resulted in many investors avoiding it as an investment. In this market view I highlight a few data points that I believe make Europe an appealing investment.

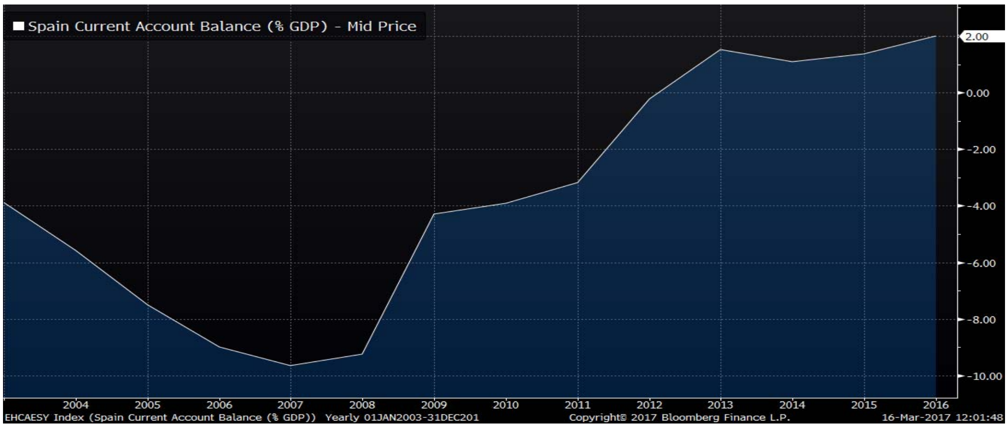
Germany now has the lowest unemployment on record. Despite the financial crisis, the German unemployment rate has fallen from 11% in 2006 to 6% today.



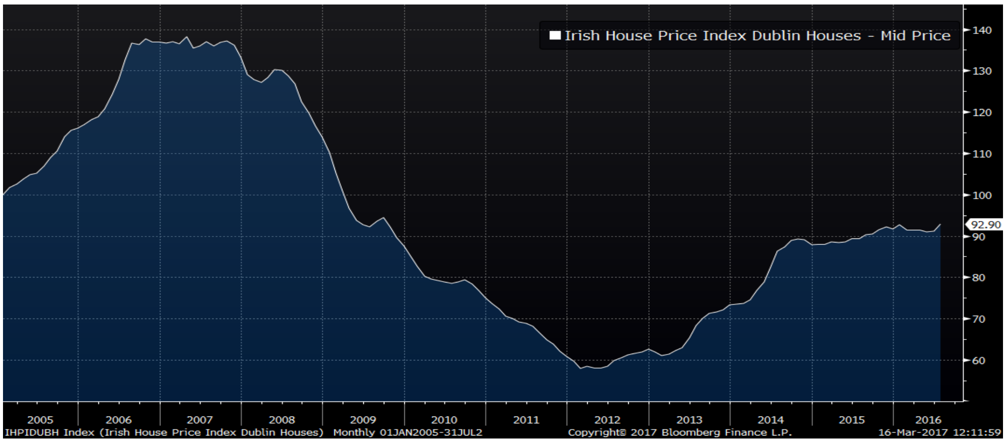
The German inflation rate has moved from close to zero during 2015 to just over 2% today. The Germans have been talking about higher interest rates for a while, but even the European Central Bank ("ECB"), for the first time, have discussed potentially increasing them, even with Quantitative Easing still ongoing.



The Spanish government did a good job bringing about reforms such as increasing the pension age and reducing the minimum wage. The economic outlook in Spain is now improving. GDP growth year on year is 3%. The real estate market has started to recover. Unemployment levels are coming down and the current account balance has turned positive for the first time.



Ireland is also benefiting from the tough decisions it took during the financial crisis. Irish GDP grew in the fourth quarter of 2016 by a remarkable 7.2%. The Dublin property market is showing real signs of a renaissance with the European headquarters of Facebook considering increasing the workforce by 25% (source: Goodbody Stockbroker).



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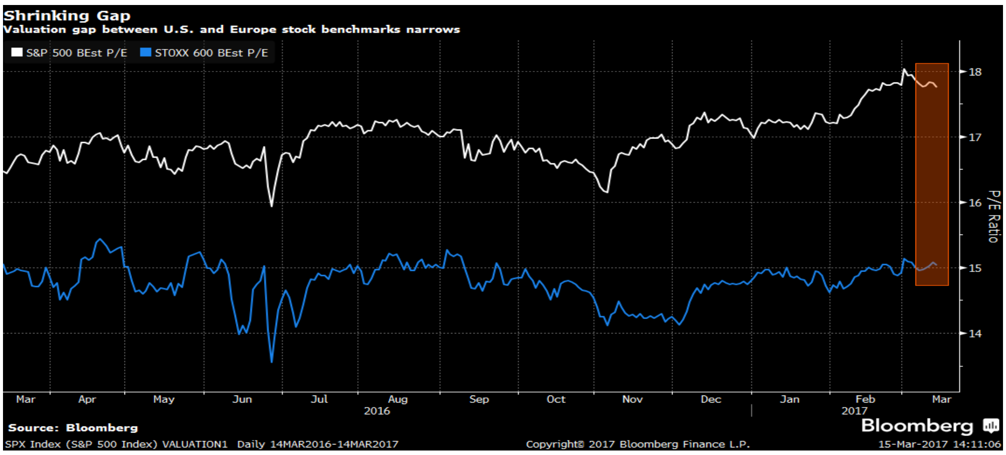
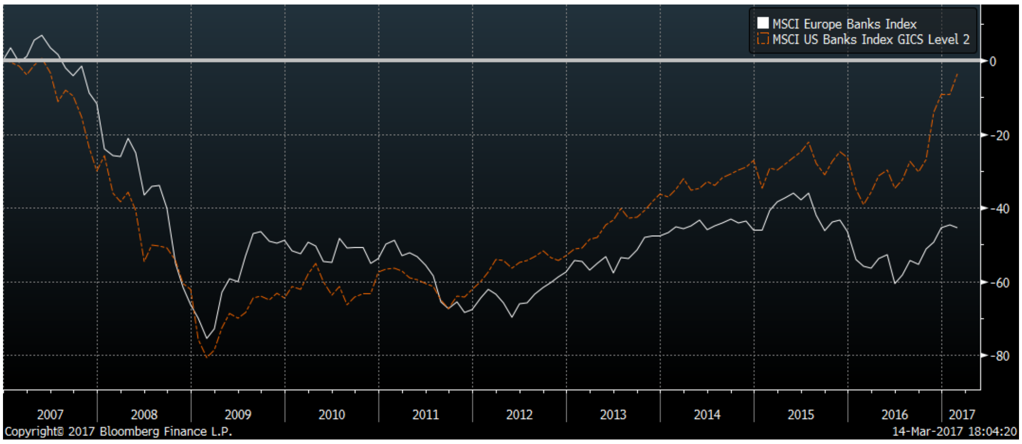


One of the biggest beneficiaries of increased economic activity and higher interest rates will be the banking sector. In Europe, banks still look very cheap on forward PEs, while US bank stocks have already been on the move.



Whilst there is no question that the political landscape could change in Europe, I believe that due to the indebtedness of European governments, any serious move by a political party to remove themselves from the Union would result in a substantial sell off in their domestic bond market. This move could bankrupt the country. Whilst bond markets are in full control we feel that any action plan to leave the European Union would be substantially watered down. The recent result of the Dutch elections points towards little appetite for the wrong kind of populism. I believe the political uncertainty gives opportunities to buy into the European region.

INFORMATION

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