Investment Insight

Friday, 28 July 2017

ARIA | CAPITAL

Euronly man: *For several years the US stock market has outperformed European stock markets. This was understandable in the context of the US's earlier and more aggressive approach to the global financial crisis, particularly the massive expansion of the Fed's balance sheet which engorged financial markets. In terms of investment flows over the past decade, European markets have lagged far behind the US as international investors gave a wide berth to Europe's varying political and financial challenges.*

However, many believe that the outlook for Europe is relatively attractive based on growth prospects and valuations. Add the significant element of "under-ownership" into the mix and it becomes still more interesting. This is a view shared by Neil Dwane, Global Strategist at Allianz Global Investors who believes that the "United States of Europe" (USE) has been a work in progress since the end of World War II that now, with fallout from the financial crisis abating and political risk subsiding, is offering some of the most compelling opportunities available to investors today. In this week's ***Inside Track*** *we take a closer look.*

Lies, damn lies and surveys*: Despite Republican majorities in both chambers, Congress has struggled to make much legislative progress since Trump's election, this week's failed Obamacare repeal efforts being the latest case in point. The latest surveys indicate that some frustration is starting to filter through to US consumer sentiment…but is it? That said, we need to be careful to look behind the surveys to divine their true meaning. In this week's* ***Pic of the Week*** *we take a closer look.*

Quoted…

"Since becoming a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said." – Alan Greenspan

The Inside Track

Neil Dwane, Global Strategist at Allianz Global Investors, believes that investors need to start increasing their allocation to European Equities. The following are some of the factors supporting this belief.

Attractive valuations compared with other equities globally

Europe's GDP and population are larger than the United States', and many European corporations generate their profits outside Europe. So why should so many European corporations – particularly those in the financial, utility and telecommunications sectors – trade at large discounts to their US competitors? The Case-Shiller P/E of US companies was almost 30 in April; at slightly over 18, Europe's was significantly lower. With European equities deeply out of fashion, investors have a contrarian opportunity.

Low or no bond yields leave little "safe return" regionally

The ECB has been extremely effective in using its monetary and bond-buying policies to lower the cost of credit below zero. This has forced other central banks in Europe – including Denmark and Switzerland – to implement negative rates of their own. As a result, European investors may soon be forced to make a "great rotation" from bonds to equities simply because there are few positive returns available from European bonds. If and when this happens, it will be all the more remarkable because Europe has traditionally had less of an equity-oriented investment culture than the US, the UK and Asia. Fortunately, European equities and alternatives – such as infrastructure debt – provide attractive-yielding alternatives, which could make the switch easier.

European economies are finally recovering

As the EU battled with austerity and a broken banking system in recent years, it struggled to find any domestic growth aside from Germany's well-tuned export machine. As a result, the EU's nominal GDP growth (which does not factor in inflation) was stuck in the 1-2 per cent range. Today, however, Europe is enjoying a positive spiral of rising consumption, improving investment and falling unemployment, and nominal GDP growth for the EU is now around 3 per cent. Though the EU still has issues – including Italy's upcoming elections and negotiations over Brexit – it has lower levels of leverage, better savings and a greater ability to increase consumption than the over-leveraged US.

Corporate earnings are rebounding after six years of decline

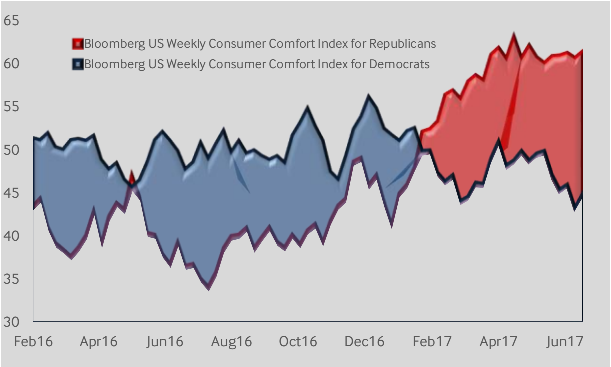
Compared with their US counterparts, corporate management teams in Europe are generally more focused on the long term. Broadly speaking, European balance sheets are also less leveraged, and corporate leaders are generally determined to make investments that improve innovation and productivity. This puts European corporations in a good position to harvest the benefits of their longer-term corporate strategies. As a result, we believe European equities could deliver annual returns in the 8-10 per cent range in the coming years – and we estimate that nearly 50 per cent of this could come from dividend income, which tends to be less volatile.

Europe's currencies are cheap and attractive

The US dollar has been a safe haven for many of the world's investors, but its zenith may be in sight. Despite Brexit, the euro and sterling seem quite undervalued. We expect global investors to spend "expensive" US dollars to acquire more attractive, higher-yielding and better-invested assets in Europe – as evidenced by several waves of merger and acquisition activity with European companies.

Pic of the Week

For the first time since November, according to a recent Bloomberg survey more Americans think the US economy is getting worse rather than better. However, was this really a survey of consumer confidence or of political support? When we look behind the numbers we see a marked difference between the perspective offered by Democrats and Republicans.



Market View

	Last 7 days	Last 12 mths	YTD	5Y Ann.
Global equities	-0.0%	+14.7%	+10.0%	+10.4%
US equities	+0.4%	+14.6%	+10.9%	+12.4%
European equities	-0.3%	+11.5%	+5.4%	+7.5%
EM equities	+0.3%	+21.5%	+23.2%	+2.4%
Irish equities	-0.1%	+16.3%	+3.8%	+16.5%
Commodities	+0.6%	-6.2%	-3.8%	-10.1%
Hedge funds	+0.1%	+5.7%	+3.6%	+2.1%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+0.8%	-0.4%	+6.1%
Germany	+0.5%	+1.6%	+1.7%
USA	+2.3%	+1.6%	+2.1%
China	+3.6%	+1.5%	+6.9%

Week ahead: Key events

31/07 Japan Industrial Production & Housing Starts
31/07 China Manufacturing PMI
31/07 UK Mortgage Approvals & Eurozone CPI
01/08 Japan & Eurozone Manufacturing PMI
01/08 Eurozone CPI
01/08 US Manufacturing PMI
02/08 Japan Consumer Confidence
03/08 China PMI Data
03/08 Eurozone Retail Sales
03/08 US Initial Jobless Claims & PMI Data
04/08 US Unemployment

Currencies	*Current*	*YTD Δ*
EUR:USD	1.17	+10.8%
EUR:GBP	0.89	+4.6%
EUR:CNY	7.87	+7.2%
GBP:USD	1.31	+5.8%
Bitcoin	2,542.92	+167.1%

Commodities	*Current*	*YTD Δ*
Gold	1,256.85	+9.1%
Copper	6,297.75	+14.0%
Oil	51.49	-12.5%
Wheat	481.50	+7.5%

Central Bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

66 Fitzwilliam Square
Dublin 2
D02 AT27
Ireland

T: (+353 1) 685 4100
E: research@aria-capital.ie
W: www.aria-capital.ie

UNDIVIDED
ATTENTION