ARIA | CAPITAL

INVESTMENT INSIGHT

A weekly look inside the investment world.

> ***Of all the things I've lost, I miss my mind the most.***
> *Ozzy Osbourne*

Friday, 26 June 2020

In this week's Investment Insight

This is Europe calling
There are philosophical, economic and investment reasons why US stocks might trade at a higher earnings multiple than their European counterparts. This doesn't take away from the fact that European investors have been quite frustrated at the disparity. However, with some US stocks looking unjustifiably pricey now, might it be time for the gap to narrow or close. In this week's Inside Track we take a look.

From Hero to Zero
It hasn't been a good week for Wirecard, until recently the posterchild of the German fintech sector. While it isn't of the gargantuan proportions that Enron was almost twenty years ago, Wirecard's demise is nonetheless signficant and losses are currently estimated at up to €4 billion. In Pic of the Week chart its rise and fall.

Newswire
Some interesting nuggets from this week's newswires.

Market view
A visual snapshot of recent market performance.

The Inside Track: This is Europe calling

Investors have waited a long time for European equities to catch up with US equities, and there are several reasons why they mightn't or shouldn't do so. However, Gabriela Santos, Global Market Strategist at JP Morgan Asset Management, explains why it may be the time for the baton to change hands.

Over the past 15 years, investors have been frustrated with the performance of European equities. During this time period, MSCI Europe ex-UK has delivered a 5.9% annualised return in US dollars relative to the 9.0% delivered by US equities. For a while now, the relative valuation argument has been strongly in Europe's favor – and still is, with Europe's price-to-earnings ratio trading at a 20% discount to the US, compared to its long-term average of 11%. But investors wonder, will investing in European equities ever pay off? There are 5 reasons to re-consider investing in European equities, in addition to valuations:

1. Western Europe has crushed its COVID-19 curve: During the dark days of late March, hard hit countries like Italy, Spain and France were seeing a daily growth rate of new COVID-19 cases at 157%, 88% and 52%, respectively (compared to 48% in the US). Now, the daily growth rate of new cases has sharply declined to only 0.1% in these countries (compared to 1% in the US). Together with enhanced testing capability and contact tracing and isolation procedures, this leaves Europe in a strong position to continue their recovery in a sustainable and confident manner.

2. Reopening is leading to a large economic growth delta: In order bring COVID-19 under control, hard-hit European countries implemented very strict quarantine measures. As a result, Google Mobility data shows that activity in retail and recreation fell to 90% below normal levels in Italy, Spain and France (compared to the US drop to “only” 45% below normal). Since early May, European countries have begun to gradually reopen and activity is rebounding smartly. In the hardest hit countries, activity is now operating at about 35% below normal – a 55%pt improvement that compares to the US’ 30%pt improvement. This will likely result in a larger hit to 2Q GDP in Europe – but also to a larger bounce in 3Q.

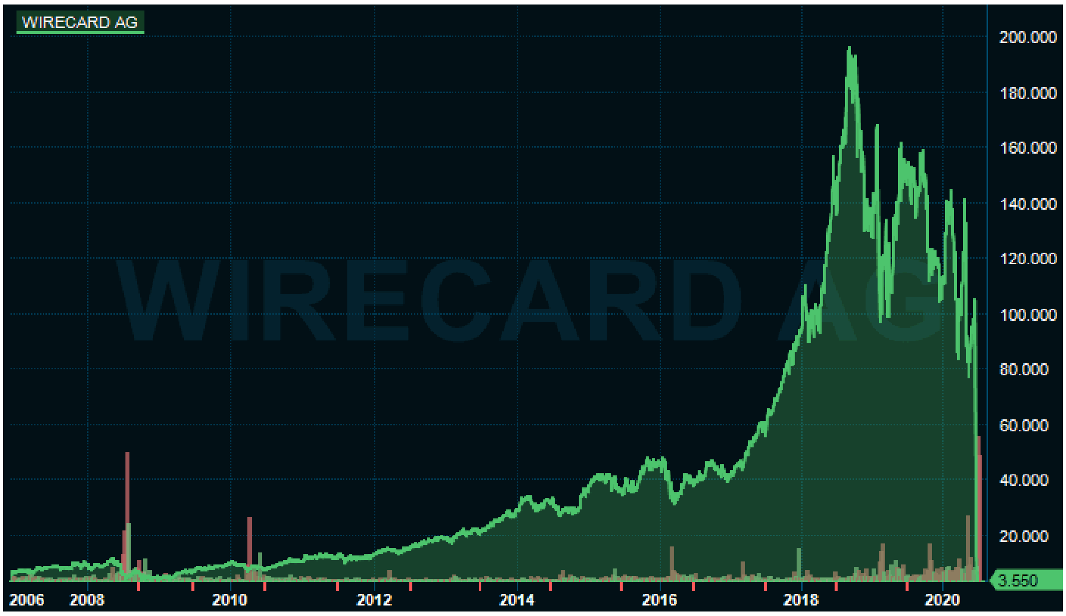
3. A “United States of Europe” might finally be possible: In the early innings of the pandemic, Europe behaved as usual, with each country responsible for its own fiscal emergency relief measures. High debt countries hoped that the European Central Bank bond purchases would be enough to keep their interest rates from rising too far too fast. However, there has now been a truly fundamental shift in Europe’s approach. The European Commission has proposed a joint €750bn recovery plan, financed by issuing joint debt backed by the EU budget and distributed based on need, to deal with the pandemic. In practice, this would mean that wealthier countries would pay more into the pot, while poorer countries would receive more out of it. While not yet final, the plan has received Germany’s approval – a first in the European project.

4. Europe’s cyclicality is a way to tap into the global recovery: One of the reasons that European equities have lagged behind the US is the sector composition of its market. It has a significantly higher representation of cyclical sectors compared to the US: 50% of market capitalisation vs. 34% in the US As the European and global economic recovery continues (and gains steam next year, likely once a vaccine is distributed), it will be exactly the cyclical regions that will outperform.

5. European equities are not just about Europe: In addition to the more positive domestic European story, European equities are also a way to gain exposure to global themes, with 54% of MSCI Europe ex-UK’s revenues coming from outside of the region. In particular, Europe is home to the largest luxury consumer brands, which are directly tapped into the growth of the emerging market middle class and their growing discretionary spending.

Pic of the Week: From Hero to Zero

There have been rumours of impropriety and suspicions of misreporting at German payments processor Wirecard for a few years now. However, investors took comfort from the knowledge that Big 4 audit firm EY had signed off on Wirecard's accounts each year over the past decade and from the extensive assurances Wirecard's management team offered to investors. Concerns lurched to an elevated level last week when publication of Wirecard's results was delayed amidst news that EY was refusing to approve this year's accounts due to their inability to confirm the existence of some €2.1 billion of Wirecard's bank deposits. Wirecard's share price fell precipitously and yesterday's insolvency announcement looks like the nail in the coffin. Wirecard had a market capitalisation of €25 billion at its peak, today it is below €2 billion and this erstwhile hero of the German fintech sector may well be headed all the way to zero. Doubtless there will be recriminations and allegations that regulators and others were asleep at the wheel. A few savvy investors saw the signs and shorted the stock, but for the majority of Wirecard's lenders and investors there is unlikely to be any payback.



Newswire

...on Monday
White House adviser Peter Navarro's comment that the US/China trade deal is over is contradicted by a Trump tweet hours later.

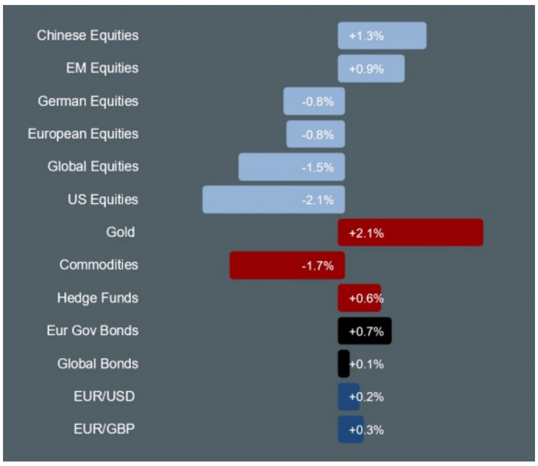
...on Tuesday
May home sales in the US were reported to have dropped to the lowest level in more than 9 years.

...on Wednesday
Stock markets fall heavily as investors fear the impact of a second wave of coronavirus infections.

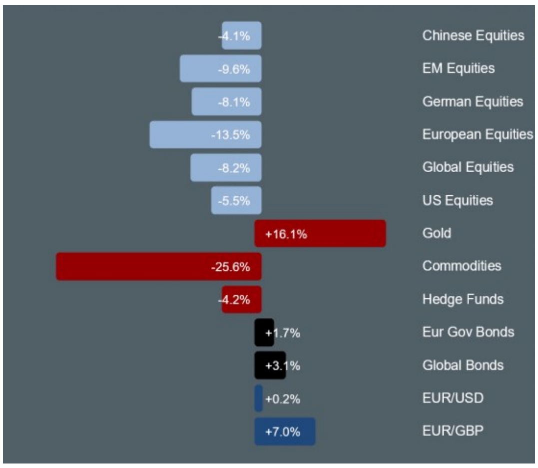
...on Thursday
German payment processor Wirecard declares insolvency following fraud allegations.

Market View

Last 7 days (€)



Year to date (€)



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