



## Friday Morning Coffee

### Nr. 45 – European equities - not as bad as their reputation

We recently came across a statement from a major US broker arguing that the recovery in global equities since the trough after the financial crisis was driven to a large extent by the strong recovery in the earnings of the underlying companies. There would only be one noticeable exception to that trend and that would be Europe. Here the recovery in stock prices would be driven purely by an expansion in valuation multiples and not by earnings growth. **So did we witness a recovery in European equities since the financial crisis driven by investors hope and not by fundamentals?** We have our doubts and therefore did our own little study on the matter.

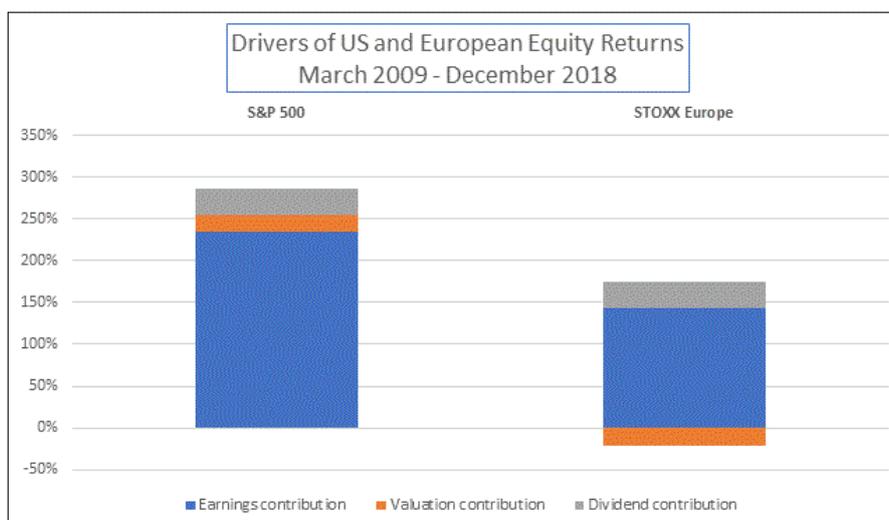
Using Bloomberg data we decomposed the total return received by investors in the US and in Europe since March 2009 into 3 main drivers :

- 1) Earnings contribution: The growth in Earnings
- 2) Valuation contribution: The expansion of the Price / Earnings valuation multiple

These 2 factors combined explain the performance of the price index over the period. **The difference of the performance of the price index and the total return of the market** is the income received via dividends giving us the third driver of total returns :

- 1) Dividend contribution: The dividends received and reinvested in the stock market

This decomposition paints a completely different picture of European equities as can be seen from the graph below :



Source: Bloomberg, ECP

The following note gives the opinion of the Investment team at the time of the publication. Please refer to important notice at the end of the document.

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It is indeed correct earnings growth has been by far been the biggest driver of the US stock market over the last 10 years. As investors gained back confidence into the solid fundamentals shown by the companies, they were also willing to put a higher valuation multiple onto these earnings. In March 2009 the S&P 500 traded at 14.4 times trailing earnings. In December 2018 the multiple had increased to 16.6 times. Add the contribution of dividends and the investor in the S&P 500 has realized a performance of 285% over the last decade.

In Europe, the total return net of dividends of 154% is still impressive, but of course somewhat more modest than in the US. The return was driven again mainly by earnings growth over the period. That earnings growth was however well inferior to the one seen in the US for many reasons like political uncertainties, Euro crisis, high regulation, different industry structure with less technology than in the US, less share buybacks and less tax reforms. What we also find remarkable is that contribution from valuation was negative. In December 2018, investors put a lower multiple on these earnings than a decade ago: the price earnings ratio went from 19 times in March 2009 to 14.9 times at the end of last year.

We conclude that earnings are growing in Europe and that fundamentals have been the biggest driver of European equities over the last decade. **At the same time sentiment on European equities has significantly deteriorated over the period and valuation multiples have come down significantly.** May be time to reassess our negative impression on European equities.

I wish you a nice weekend,

Léon Kirch, CFA  
Partner & Chief Investment Officer  
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