Friday Morning Coffee

Nr. 85 — Christmas double issue

With the year-end festivities and a new decade just around the corner, I wanted to wrap-up the current state of affairs in European value land in a slightly longer morning coffee. In order to keep it short, I am however not overloading the morning coffee with text, but instead summarize the current state of affairs in European value-land with 4 hopefully self-explaining graphs:

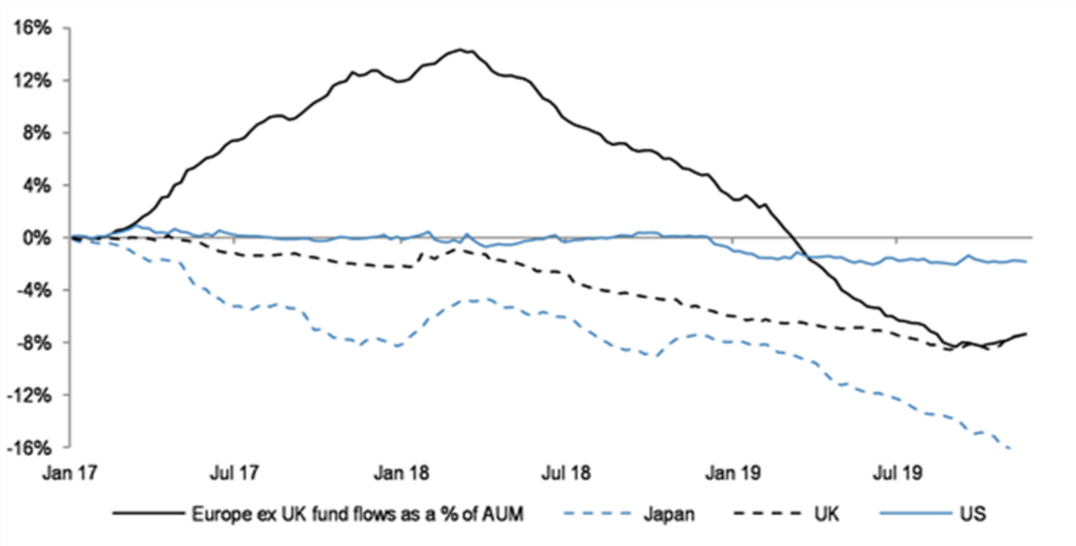
1. Graph 1: European equities are attractively valued

Despite the run-up, **European equities remain attractive on most valuation measures compared to their own history and compared to other developed markets like the US**. In the graph below, we compare attractiveness of equities versus bonds (measured by dividend yields – 10 year bond yields) in different regions: Europe (black line), UK (purple line) and US (blue line).

Source: Bloomberg

2. Graph 2: Positioning in European equities remains light

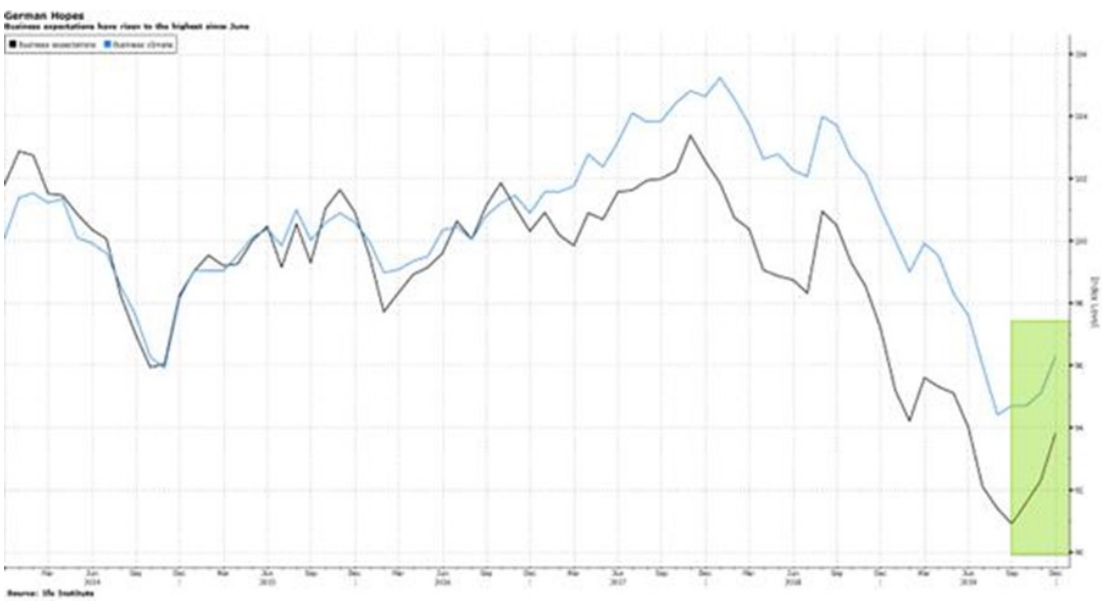
European equities remain an out-of-favor asset class with more than 100 bn USD outflows this year alone. Over the last weeks, investors appear however to rediscover Europe and we saw timid inflows again. More clarity on Brexit, better news on tariffs and improving economic sentiment could see this trend continuing.



Source: JPMorgan

3. **Graph 3: Signs of improving business sentiment in Germany**

Recent economic data suggest indeed an improvement in business sentiment in the Germany. This increase in sentiment, partly on the back of the recent U.S.-China trade agreement, is still fragile and just the first step. As a reminder that the road to better economic hard data is still shaky, both industrial production and factory orders dropped at the start of the fourth quarter. The graph below shows the improving business sentiment (black line) and business expectations (blue line) amongst the 9000 German companies surveyed by IFO.



Source: Bloomberg

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4. Graph 4: Interest rates start to provide support to value

The valuation gap between growth and value stocks remains at an all-time high. One reason are the low interest rates in place since the financial crisis. There is indeed a strong correlation between interest rates (in this case the US ten year treasury yield (yellow line) and the performance of MSCI Europe Value against MSCI Europe Growth (black line). US interest rates (yellow line) have been edging up over the last weeks towards 2% supported by solid US economic data and retreating risks of escalating tariff war.

From the above, **we conclude that European value equities are the place to be for 2020 with the usual disclaimer that we are talking our own book here. Our European portfolio stays attractively valued with the average company trading at 36% compared to our estimated fair value. The companies we are invested in have solid balance sheets, generate solid cash flows and, for most of them, pay juicy dividends. In our world, that is a good entry point for 2020.**

The whole team of ECP and myself wish you a Merry Christmas and a good start into the new year.

Léon Kirch, CFA
Partner & Chief Investment Officer
December 20 th, 2019