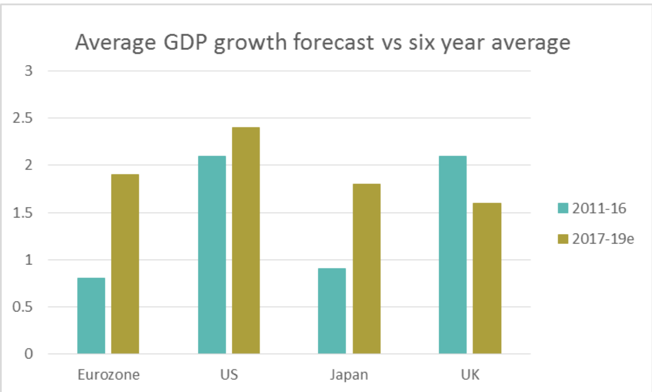
SARACEN
share success

How attractive is Europe?

We might be in the process of negotiating our exit from the European Union, but looking towards the continent from an investor's point of view, what are the attractive investment destinations across the channel?

After the financial crisis, the US made very swift changes to its banking system. Despite some high profile bankruptcies like Lehman Brothers and Bear Stearns, the remaining financial institutions restructured very quickly. This was helped by a variety of factors like low interest rates, QE and capital raises in the market. But most importantly, the quick write off of bad debt helped to recover capital ratios (the amount of cash they are required keep on their balance sheets) back to adequate levels and leave the crisis in the rear-view mirror. For both the banking system and the wider economy in general, this meant it was almost back to business as usual a mere two years after the downturn. Banks started lending again, companies and consumers to a certain extend increased their borrowing and the economy moved back to an even keel.

Move across the Atlantic and it's a very different picture. European institutions were very reluctant to write off bad debt as this did not sit well with the European regulator. Equally, the ECB was very late to initiate a Quantitative Easing programme. Loan growth originally picked up in 2011 only to turn negative again towards the end of 2012 and into 2013. European institutions were hesitant to lend to the private sector, who in turn were reluctant to increase investments. As a consequence, European GDP turned negative again in 2013 after the initial recovery post the financial crisis. In fact, looking at GDP levels for 2016 vs. 2009 the US managed to grow by 29% (3.7% CAGR) while the EU's GDP increased by 18% (2.4% CAGR).



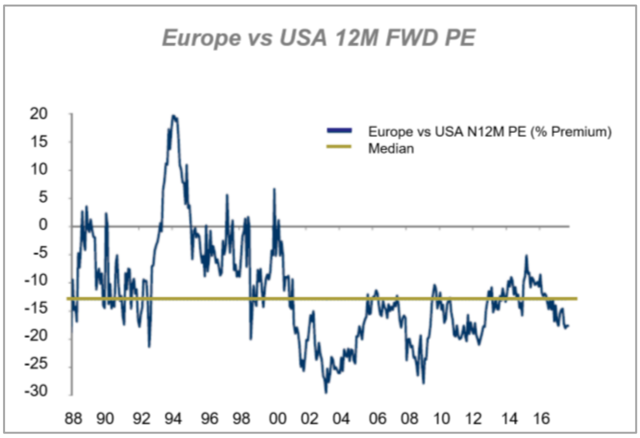
Source: Berenberg, Eurostat, Bureau of Economic Analysis, Cabinet Office of Japan, Office of National Statistics

There are more factors driving the stock market performance than just GDP growth, although it is a big influencer. Furthermore, when comparing the US and EU stock market returns since the lows of 2009, we see a big discrepancy: +212% for the Dow Jones vs. +87% for the Stoxx Europe 50.

Europe has a lot of catching up to do, and it looks like it's finally happening. The implementation of QE, further bank restructuring and improving European consumer confidence are all contributing to a more positive outlook. This is reflected in leading indicators like IFO business expectations, capacity utilisation and bank lending picking up.

At Saracen Fund Managers we analyse a company's prospects over the long term, typically forecasting out five years. We are not constrained by a benchmark or by geography, instead we look at companies by geographic sales distribution. There are three main reasons why we find European shares more attractive than their US counterparts at present:
First, they tend to have a higher revenue distribution in Europe and therefore better sales prospects.
Secondly, they have more restructuring opportunities left as they started later in the cycle and this should lead to better margin progression.
Finally, and most importantly, is valuation, which is at the heart of every investment decision we make.

At present, European shares trade at a larger discount than normal to US shares. While this was justified for most of the last decade, we feel in the current environment this discount should close.



Source: MSCI, Morgan Stanley

All this is reflected in the TB Global Income & Growth Fund where we own shares in German chemical company Evonik, French building materials company Saint Gobain, French electrical equipment maker Schneider, Swedish bank Handelsbanken, Swiss bank UBS and since its recent IPO Allied Irish Bank, to name just a few.

So for us, Europe offers plenty of attractions. Pickup in economic growth, self-help for companies and revaluation. What's not to like?

Written by: Bettina Edmondston, Global Investment Analyst