MAERKI BAUMANN & CO. AG

PRIVATBANK

Eurozone equities – an appropriate addition to a portfolio

Market Comment July 2020

Following a prolonged period in which the Federal Reserve (Fed) provided the greatest degree of economic stimulus of any of the world's key central banks and the European Central Bank (ECB) adopted a less expansionary stance, the latter has now ratcheted things up dramatically since June. The announced increase in the injection of liquidity from EUR 750 bn to EUR 1,350 bn will provide the Eurozone with emphatic economic and market support. At the same time, the Eurozone's economic data is improving at a faster rate than expected, with the governments of EU member states providing additional economic stimulus. Furthermore, the valuations of Eurozone equities are attractive when compared to the MSCI World Index – making them an interesting supplement to other investments.

The last few weeks have seen greater clarity emerge in the financial markets with regard to fundamental developments. A trend towards economic improvement can now be discerned at a global level. As well as having recorded a month-on-month rise, the leading indicators of Eurozone countries have also turned out to be much stronger than expected. For example, the Composite PMI for France not only rose from 32.1 to 46.8, as expected, but has pushed on to 51.3, indicating economic expansion rather than merely less of a contraction. The leading indicators for Germany and the Eurozone as a whole have also improved by more than the market's consensus expectations. The upward trend extended not just to new orders but also to exports. Moreover, economic improvements in the Eurozone are very apparent not just in the services sector, but also in manufacturing.

A significant economic recovery is also evident in other countries of importance to Eurozone equities. China and the United States are particularly significant for European exporters. In China, year-on-year growth in retail sales lagged at –15% until recently, but consumer spending is now virtually back to the same level as last year. In the United States, too, consumer spending has recovered more rapidly than expected. For example, retail sales recorded a month-on-month rise of 18% in May, which is also a good indication of a pick-up in demand for Eurozone companies. As the Eurozone is particularly dependent on export developments, both in terms of the economy and due to the weighting of equity sectors, Eurozone equities could be more interesting in phases of global recovery than the MSCI World Index or the S&P 500. This has often proved true in previous phases of recovery.

The euro has likewise performed strongly in the past versus the US dollar and other currencies against the backdrop of an improving economy. Furthermore, the euro is currently some 15% undervalued versus the US dollar and the Swiss franc when viewed in terms of historic purchasing power parity.

Until recently, the Fed had been a stronger influence than the ECB with regard to economic and stock market stimulus. But with its decision to ramp up its quantitative easing (QE) programme from a volume of EUR 750 bn to EUR 1,350 bn, the ECB has emerged as a kind of "game changer" for the Eurozone. Thanks to the massive increase in the purchases of securities, and particularly corporate bonds, the issue of financing has become significantly easier for Eurozone companies. Financing costs are coming down accordingly, which will have a positive impact on the results of Eurozone stocks. The far greater degree of economic stimulus now being provided by the ECB is also giving a further boost to the Eurozone economy, which has already shown signs of clear improvement in recent months.

> The price/book value ratio of Eurozone equities is some 35% lower than that of the MSCI World Index, making the former cheap by historical standards.
>
> Gérard Piasko, Chief Investment Officer

As an additional factor, the Eurozone economy is also being stimulated by government action, such as the recovery fund planned by Merkel and Macron for the EU, as well as various degrees of national stimulus.

For all these reasons, Eurozone equities currently represent an attractive supplement to an investment portfolio that is otherwise fundamentally focused on Swiss or US equities. As a result, the Investment Committee of our bank decided at its most recent meeting to increase exposure to Eurozone equities in order to benefit from the aforementioned trends: clear economic improvement, additional economic support from governments and – above all – massive economic and market stimulus thanks to the increase in the ECB's QE programme from EUR 750 bn to EUR 1,350 bn.

Another argument in favour of European shares right now is the fact that the balance between upward and downward earnings revisions by analysts has been improving for the Eurozone for a number of weeks. In other words, earnings revisions are now moving upwards as a whole, which indicates improved earnings momentum for Eurozone equities. As an additional factor, the performance of Eurozone equities has lagged behind that of US and Swiss equities since the start of the year, which gives the former a certain degree of catch-up potential – an additional reason to supplement a portfolio with Eurozone equities.

But what about the relative valuation of Eurozone equities in a wider comparison? For one thing, the yield on Eurozone bonds is particularly low, and lower than in the US – indeed, in the majority of cases yields are in negative territory. In addition, the dividend yield of Eurozone equities is just under 3%, which is far superior to Eurozone bond yields, higher than US bond and dividend yields, as well as higher than the dividend yield of the MSCI World. Last but not least, the relative valuation of Eurozone equities is very interesting when compared to the valuation of the MSCI World: the price/book value ratio of Eurozone equities is some 35% lower than that of the MSCI World, making the former cheap by historical standards. The price/earnings ratio is also around 15% lower than that of the MSCI World (as per mid of July 2020).

Gérard Piasko

Gérard Piasko is CIO and head of the investment committee of private bank Maerki Baumann & Co. AG. Before he was for many years CIO of Julius Baer, Sal. Oppenheim and Deutsche Bank.

Modular investments with Maerki Baumann

The topics of the current market comment concern tollowing focus modules:

Equities Switzerland	Equities USA	Bonds CHF	Global Balanced
Small & Mid Caps Switzerland	Equities Emerging Markets	Bonds EUR	Commodities
Equities Eurozone	Equities Global Impact	Bonds USD	
Equities Germany		Bonds Emerging Markets	

Please contact your client advisor for further information or visit our website.
www.maerki-baumann.ch/modular-investments

Editorial deadline: 7 July 2020

Maerki Baumann & Co. AG
Dreikönigstrasse 6, CH-8002 Zurich
T +41 44 286 25 25, info@maerki-baumann.ch
www.maerki-baumann.ch