

Are European Equities a Value Trap?

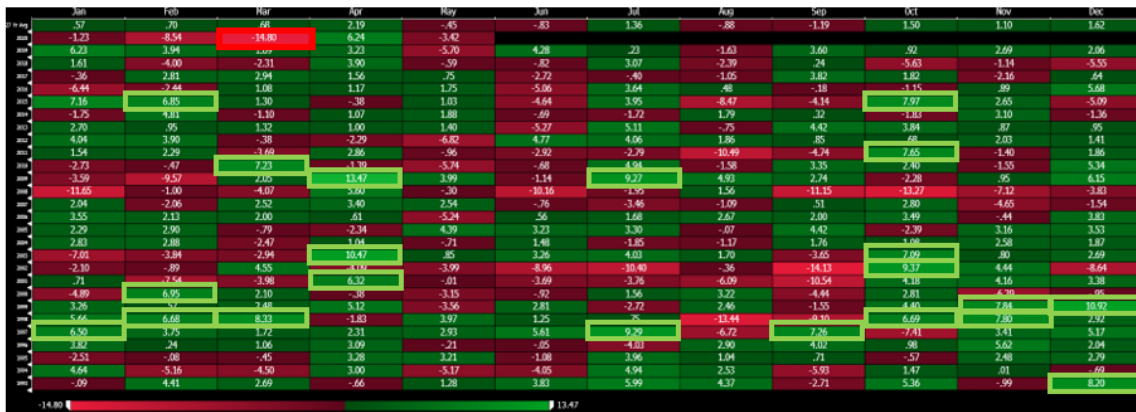
What a difference a month makes. The S&P 500, Having posted the largest single month decline since October 2008 in March, in April we saw the biggest single month rise since January 1987.

S&P 500 Index Monthly Returns in Percent since 1993:

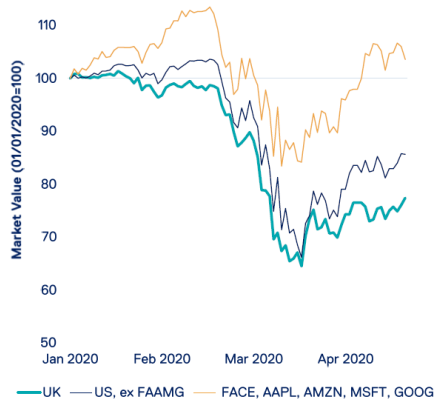


The Index now sits at a higher level than it was trading at a year ago. This poses a dilemma - does the outlook really look as good as it did a year ago despite companies feeling unable to provide guidance, or is the index now overvalued? We showed last week that the earnings estimates for this year have fallen to a similar level to those at the end of 2017, so something is appears to be out of sync. By comparison, the Eurostoxx 600 Index, which includes the UK, had its worst monthly performance since October 1987, while the rebound in April was not as pronounced as that seen in the US. As the chart below shows in the past 30 years, we have experienced 21 occasions when the monthly return has exceeded that seen last month (i.e. April 2020). Conversely, this raises the question as to whether value is to be found in European equities rather than US ones given the lack of re-rating that has occurred versus that in their trans-Atlantic peers.

Eurostoxx 600 Index Monthly Returns in Percent since 1993:



With Microsoft, Apple, Alphabet, Amazon and Facebook accounting for 22% of the S&P 500 market cap, a significant part of this divergence in re-rating has been down to a remarkably small number of companies, without which the outperformance of the US is less pronounced.



Europe's list of companies that are leaders in a digital world are somewhat sparse in comparison. Given that 67.6% of America's GDP comes from the consumer spending, and Asia has a growing middle class, Europe is undoubtedly at a structural disadvantage at times of low global growth owing to the high dependency on exports (49.2% of GDP) and an aging population. The composition of the indices reflects this and thus for Europe to outperform it is more likely to come from the 'value' end of the spectrum.

| S&P 500 | Sector | Eurostoxx 600 | Difference |
|---------|------------------------|---------------|------------|
| 15.47% | Health Care | 17.36% | -1.89% |
| 10.55% | Financials | 15.23% | -4.68% |
| 7.50% | Consumer Staples | 14.49% | -6.99% |
| 7.92% | Industrials | 12.92% | -5.00% |
| 10.28% | Consumer Discretionary | 9.29% | 0.99% |
| 2.51% | Materials | 8.32% | -5.81% |
| 25.68% | Information Technology | 7.10% | 18.58% |
| 3.28% | Utilities | 4.76% | -1.48% |
| 10.98% | Communication Services | 4.16% | 6.82% |
| 2.94% | Energy | 4.21% | -1.27% |
| 2.90% | Real Estate | 2.17% | 0.73% |

The VT Tyndall Global Select Fund has 30.4% of its holdings listed in Western Europe, but we have always preferred to look at companies on a basis of where they derive their profits and see country of listing as market 'noise'; 29.9% of revenues come from Greater Europe, the Middle East and Africa. Furthermore, despite the headwinds facing Western Europe, there will always be world leading franchises buried

within this area, which can overcome their region of domicile. As bottom-up investors we should not be, and are not, averse to holding European equities, and value opportunities can be found. However, we remain mindful that, as in every region, there are value-traps aplenty that need to be avoided.

Richard Scrope, CFA, VT Tyndall Global Select Fund, 7th May 2020

Sources: Bloomberg & Refinitiv

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