

# THE CASE FOR EUROPE





# BREADTH OF EXPERTISE

Janus Henderson manages €21.45bn\*  
assets in European equities.

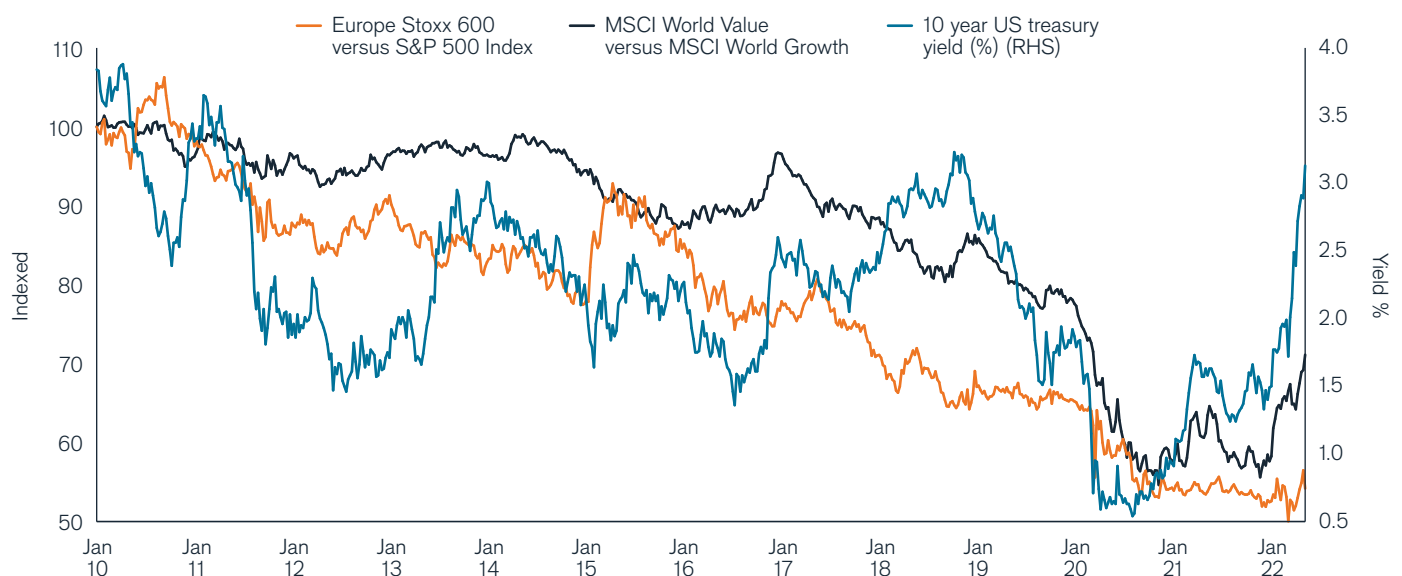
\*Janus Henderson, as at 31 March 2022.

# WILL THIS CYCLE BE BETTER FOR EUROPE?

For the past decade, the deflationary economy has driven bond yields lower creating the perfect environment for high growth stocks to flourish. This backdrop saw growth stocks outperform value stocks, with the US leading the growth

charge while Europe, which is considerably more value-oriented, lagged. As inflation soars and rates rise, we believe that this could be the turning point for value to finally outperform growth, with Europe offering a catch-up trade.

Figure 1: Europe – a catch-up trade?



Source: Janus Henderson Investors, Refinitiv DataStream, as at 6 May 2022. For illustrative purposes only.

## ECB policy action characterised by speed and volume

Since the Global Financial Crisis, Europe has faced both political and economic challenges, leaving behind an arid environment for European companies to operate in. The Institute of International Finance research suggests that Europe's prolonged austerity – limiting debt, country deficits and ultimately, government spending – and policy inaction reduced GDP growth by 10% in Europe compared to the US.<sup>1</sup> Coupled with the challenging political construct of a European monetary union without a political union and the two-speed growth rate of Northern Europe versus Southern Europe, the continent has suffered.

Fast forward to current day, and the policy response to the COVID-19 crisis has been faster and larger than ever before. Governments have been keen not to enact painful austerity policies, instead focusing on implementing groundbreaking funds to ease the COVID burden.

In 2020, in order to lower borrowing costs and increase lending in the euro area, the European Central Bank (ECB) announced massive amounts of asset purchasing alongside relaxed capital requirements for banks. Rigid rules surrounding country budget and inflation targeting slackened, offering space for European economics to recover from the economic shock of the crisis.

In short, Europe's hangover from the latest crisis has been far less severe this time around.

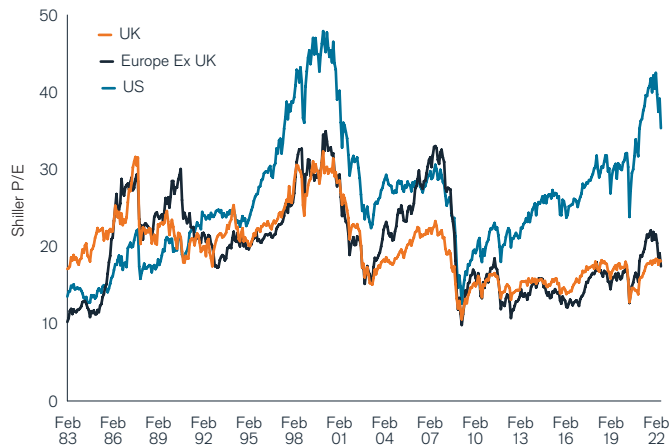
<sup>1</sup>Haver, Institute of International Finance, 2018

# WHY EUROPE NOW?

## EUROPE IS ATTRACTIVELY VALUED

As it stands, Europe appears cheap. The valuation gap between Europe and the US (measured by Shiller P/E as shown in figure 2) is at an extreme, presenting what looks like an attractive entry point for European equities. Coupled with an accommodative ECB, the economic backdrop for European equities is promising.

Figure 2: The valuation gap between Europe and the US














Source: Janus Henderson Investors, Refinitiv Datastream, from 1 February 1983 to 1 May 2021.

## EUROPE IS A DIVERSE AND ROBUST MARKET

Global asset allocators often refer to Europe as a value play or an area to tactically allocate when more cyclicality is required, especially given the underperformance versus the US over the last decade and the region's relatively high exposure to financials and industrials. What this view fails to recognise is that Europe is home to a wide array of world-leading companies that command a global market share – see figure 3.

From fledgling markets such as energy-efficient lighting used in vertical farming to dialysis care, luxury goods and environmentally friendly animal feed, these companies offer diverse products with sturdy fundamentals that have managed to thrive in what has been a lacklustre macroeconomic environment. This diversity allows European investors to balance exposure between attractively priced cyclical companies and those with dominant market shares geared into secular growth themes.

Figure 3: Europe is home to an array of battle-hardened, world-beating companies

|   |   |  |                          |
|---|---|--|--------------------------|
|  <b>ARKEMA</b>                 | Chemicals                                 |  <b>Nestlé</b>        | Consumer goods           |
|  <b>ASML</b>                   | Lithography tools, enabling 'Moore's law' | <b>LVMH</b>  | Fashion                  |
|  <b>Lindt</b>                  | Chocolate production                      |  <b>novo nordisk</b>  | Insulin products         |
|  <b>DSM</b>                    | Vitamins and animal feed                  |  <b>signify</b>      | Lighting                 |
|  <b>FRESENIUS MEDICAL CARE</b> | Dialysis                                  |  <b>TotalEnergies</b> | Oil and renewables       |
|  <b>Mercedes-Benz</b>          | Premium autos                             |  <b>UPM</b>           | Pulp, paper and biofuels |

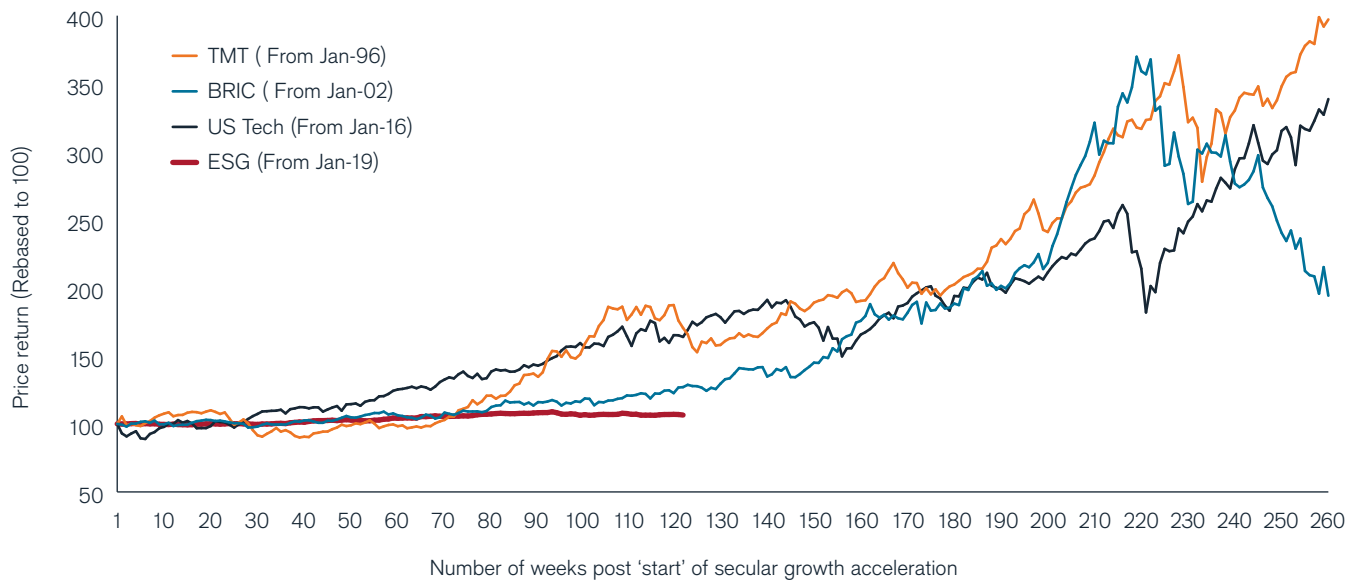
Note: References made to individual securities should not constitute or form part of any offer or solicitation to issue, sell, subscribe or purchase, and neither should be assumed profitable.

# THE DECADE OF SUSTAINABILITY

The past decade can be defined by the pace of mega cap technology, which has dominated the airwaves and shaped the world we live in today. Tech giants have led markets for the past decade, boosting the US indexes which they occupied, while Europe's lack of exposure has caused the region to tail behind. However, while mega cap tech faces scrutiny over anticompetitive behaviour, employment standards and

broadcasting of 'fake news', environmental, social and governance (ESG) factors have increased in importance. Investors are holding companies to account for the way they operate and the products/services they provide, poring over companies' ESG credentials. Around the world, sustainable practices will play a pivotal role in defining the future of companies. Could ESG be the next secular growth theme?

Figure 4: ESG – a theme in its infancy



Source: Janus Henderson Investors, as at 30 December 2020. Note: TMT (from Jan 1996) – Datastream World Telecom, IT and Media Index vs Datastream World Market Index, BRICs (from Jan 2002) – MSCI BRIC Index vs MSCI World Index, US Tech Index (from Jan 2016) – MSCI USA Information Technology Index vs MSCI USA Index and ESG (from Jan 2019) – MSCI Europe ESG Leaders Index vs MSCI Europe Index. **Past performance does not predict future returns.**

Europe is home to the market leaders in energy. In fact, 8 out of the top 10 renewable energy companies (ex-China) are domiciled in Europe.

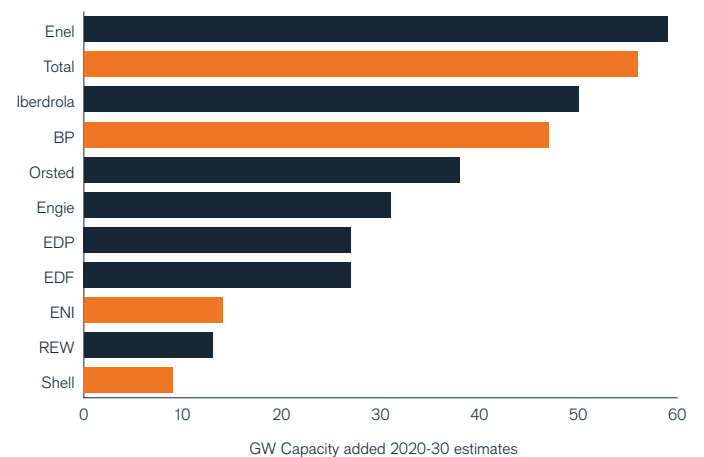
Figure 5: Europe dominates the renewable energy space

| Company                   | Domicile | Installed capacity (GW) |
|---------------------------|----------|-------------------------|
| Iberdrola                 | Europe   | 22                      |
| NextEra                   | US       | 17                      |
| Enel                      | Europe   | 16                      |
| Berkshire Hathaway Energy | US       | 12                      |
| EDP                       | Europe   | 12                      |
| EDF                       | Europe   | 11                      |
| Orsted                    | Europe   | 9                       |
| RWE                       | Europe   | 9                       |
| Acciona Energia           | Europe   | 8                       |
| Engie                     | Europe   | 7                       |

Source: Janus Henderson Investors, Goldman Sachs Research, as at 31 December 2021. GW – Gigawatt. Numbers based on 2020 financial year.

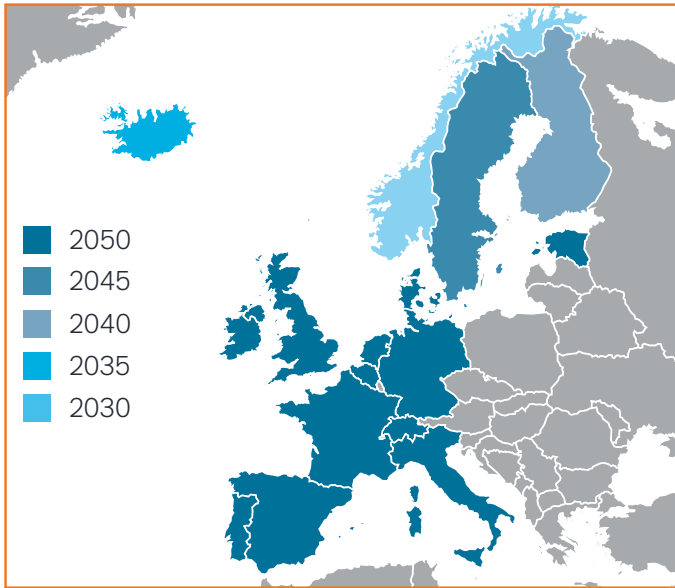
Not only do these companies already have large installed bases, but their growth plans are also impressive – see figure 6. It is also noteworthy that many of the 'oil' majors have large renewable energy growth plans.

Figure 6: Growth in renewable capacity



Source: Janus Henderson Investors, Exane Research, as at 31 January 2022. Note: Forecasts based on company guidance or Exane research estimates. Black bars represent utility stocks, orange bars represent energy stocks.

## EUROPE HAS MADE CLIMATE CHANGE ONE OF ITS TOP PRIORITIES



Source: Energy and Climate Intelligence Unit, Barclays Research.

A large element of ESG is sustainability. Europe is leading in the crusade to ensure that sustainability and climate change are at the top of the agenda. The European Green Deal aims to make the 27-country bloc net zero carbon by 2050. In December 2020, EU leaders proposed a new, more aggressive target to cut greenhouse gas emissions by 55% by 2030, compared to 1990 levels, positioning Europe as one of the most ambitious regions in tackling the problems associated with climate change.

These endeavours have been bolstered by the EU Recovery Fund, which has put sustainability at the core of efforts to repair the economic and social damage caused by the COVID-19 pandemic. A €1.8 trillion stimulus package has been agreed to build a greener and more resilient Europe. Among the European Commission’s priority areas are renewable energy, green mobility, a renovation wave and hydrogen. These priorities will act as a tailwind to many sectors in Europe.

## The European Commission’s four priority areas

### RENEWABLE ENERGY

DOUBLING EU RENEWABLE ELECTRICITY PRODUCTION BY 2030

**Beneficiaries**

- Utilities
- Offshore infrastructure (cabling)



### GREEN MOBILITY

NEAR-TERM FOCUS ON RAIL AND ELECTRIC VEHICLES

**Beneficiaries**

- Railway infrastructure
- Electric vehicles (autos and trucks)



### RENOVATION WAVE

DOUBLING THE RENOVATION RATE FROM 2026

**Beneficiaries**

- Building materials
- Lighting
- Ventilation



### HYDROGEN

AMBITIOUS GROWTH IN RENEWABLE HYDROGEN IN 2023

**Beneficiaries**

- Utilities
- Industrial gases
- Fuel cell infrastructure



## AT A GLANCE

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### EUROPE IS A CYCLICAL MARKET

The region is home to many financial, energy, material and industrial companies, which tend to do better than their defensive counterparts when emerging from a downturn. The cyclical rebound from the COVID crisis is unlikely to have fully played out at this point.

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### INFLATION – STRONGER FOR LONGER

While it is difficult to predict the pathway for inflation, abating supply chain issues, removal of excess liquidity and slowing global growth all suggest that inflation could begin to peak in Q2 2022. However, we expect it to stay higher than the last cycle given the lasting effects of stimulus, increasing capital expenditure (capex) and the ESG energy transition – all of which are inflationary.

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### NO RETURN TO AUSTERITY

The European recovery is less likely to be thwarted by sudden withdrawal of central bank support, which may not be true for the US. With core inflation less extreme in Europe than in the US, markets have priced in far fewer rate hikes versus the US. This should provide stability to European markets. Although central banks have been forced to pivot to a more hawkish stance, the ECB looks like it will be less aggressive than the US Federal Reserve, given lower core inflation, and there seems to be little appetite from governments to return to the austerity agenda.

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