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Why Some European Equities Offer Better Value Than U.S. Stocks

- Juliette Fairley
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NEW YORK (MainStreet) — Alphonso Barrett invests automatically in his 401(k) plan but only has domestic exposure. “I don’t invest in European stocks,” Barrett told *MainStreet*. “Right now it would not be a great investment, because of what is going there.”

The 44-year-old IT asset manager wants to wait until the continent stabilizes. “If I were to invest in European stocks, I would look to the U.K, because it seems more stable than other areas like Greece,” he said.

European equity funds experienced some $5.7 million in outflows in October alone last year, according to Bank of America Merrill Lynch. And the continent’s growth outlook continues to be tepid. “There are many reason Europe’s equity markets struggle,” said Jerry Braakman, chief investment officer with First American Trust, a financial services company in Orange County. “Russian political tensions are a black cloud with serious trade implications for Germany which would spill over to the rest of Europe.”

Despite the sell off, T. Rowe Price Portfolio Manager Dean Tenerelli thinks investors are overreacting.

“Unloved by many, Europe’s equity markets offer better value than is commonly realized," Tenerelli said.

Hardship Presents Robust Opportunity

For one thing, European equity valuations are lower relative to the U.S. market based on price/earnings multiples.

“Opportunity may exist if your outlook is optimistic on the outcome of Ukraine, continued low oil, continued low euro exchange rates and Greek debt agreements being resolved amicably,” Braakman told *MainStreet*.

More stable countries in Scandinavia and Northern Europe are attractive due to exposures in consumer spending, staples and healthcare sectors.

Braakman favors Novartis, Nestle, Inbev and Roche holdings.

“But we would avoid financials and trade dependent sectors even in those countries,” Braakman said.

Domestically, the fact that oil prices ended 2014 more than 45% lower than a year earlier is a good thing.

“Continued low oil prices will boost the U.S. economy, providing a lift to discretionary spending and supporting equity markets,” said Braakman.

An expected hike in short-term U.S. interest rates in 2015 is likely to lead to lower bond returns at home while central bank easing abroad could create opportunities in some markets. That's why European exposure could be a smart move.

“Because of uncertainty as to the direction of rates and global growth, a diversified approach is recommended with duration, sector and geographic exposure,” said Braakman.

One way to position bonds is lower the volatility of an investment portfolio but specific concentrations can implode unexpectedly. “Broadly diversified core strategy bond funds are good vehicles to achieve exposure,” Braakman said.

Examples of core bond funds include PIMCO Total Return Fund (PTTDX), Vanguard S/T Invest Grade (VFSUX) or ETFs such as the iShares Barclays Aggregate (AGG) and iShares iBoxx Investment Grade (LQD).

--*Written for MainStreet by Juliette Fairley*