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Six months after the Covid-crash, will the European stock market start to perform better than Wall Street and close the 10-point gap that currently exists?

- After short-lived outperformance in the spring, European stocks have remained stuck in a range for a few months, with the US equity rally continuing in the meantime.
- Plenty of arguments support European equities, but while we believe they can once again play catch up in the short term, we believe US stocks, in part thanks to the structural overweight to growth and quality sectors, will likely remain in the lead over the medium term.
- European equities got a boost from the European Recovery Fund announcement, as further integration and cooperation help reduce the risk premium on assets from a European breakup and support the periphery. Europe has handled the pandemic better and was able to reopen sooner and in a smoother way. Interest rate differentials have finally evened out and supported the euro, making European assets more attractive to foreign investors.
- However, European growth is still very export-oriented and therefore depends on the US recovery (and others), suggesting there is only limited growth upside without a strong US recovery as well. Yes, Europe handled the health crisis better, but summer holidays are leading to the beginnings of a second wave in many countries, and we'll need to see how this resurgence is handled – at the same time, the US numbers are finally peaking, with activity picking up again after a softer summer. While further steps towards fiscal integration are encouraging, and should support longer-term growth prospects for the Eurozone, the question of unemployment remains as many short-term schemes are meant to expire, which could see unemployment gradually rise, while it is retreating in the US. Finally, earnings have proven more resilient in the US, in part thanks to a very strong tech sector, which suggests ongoing strong performance.
- Yes, plenty of factors should support European equities. And there is a lot of room for them to catch up. But European stocks might not have a strong enough catalyst for outperformance. And any outperformance would need to come from a loss of leadership from the US tech sector, which appears unlikely over the medium term.

What factors can influence the behaviour of both stock markets?

- A stronger euro has made European assets more attractive to foreign investors, but at some point it will start to weigh on the Old Continent and its exports
- While investors do not appear concerned over Brexit and we believe some kind of mini-deal or agreement on strategic sectors is likely, more volatility could come as we head into the end of the year.
- With a more open economy, Europe need the US recovery, as well as China, to continue to rebound.
- Unemployment – European countries will need to extend fiscal measures to prevent skyrocketing unemployment

- More cyclical sectors need to start to perform better, as Europe is more Cyclical / Value biased and the US is more growth / Defensive biased. More confidence in the recovery and the end of the pandemic would lead to better performance from cyclicals. And a broadening of the rally overall would support European assets.
- In the US, volatility is likely to rise on US-China tensions and the upcoming US elections, but we do not expect a prolonged sell-off. Congress needs to pass the CARES Act 2 (phase 4). Tech leadership is important to US broad market performance.