RenditeWerk

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Essay by Hans Peter Schupp in **Renditewerk**
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Europe's stock markets are massively underrated!

The hype around artificial intelligence has driven American stocks up this year. Europe, on the other hand, has little to offer when it comes to this megatrend. While AI plays an important role in almost every industry, the big and clear winners from a stock market perspective are to be found in the US-dominated tech world. Here, the companies are considered to have the greatest expertise and are provided with the corresponding financial resources by investors. However, it must also be noted that it is primarily the so-called big players that are responsible for the upswing, namely the "Magnificent Seven" Apple, Microsoft, Nvidia, Alphabet, Meta Platforms, Amazon and Tesla. They are responsible for most of the price gains on Wall Street and the Nasdaq.

European stock market is better than its reputation

But Europe is better than its reputation, as European stocks are doing remarkably well. They are doing even better than most investors had expected, as looking at the Stoxx Europe 600 (including the UK and Switzerland) reveals. Over the past 10 years, the Stoxx 600 has achieved an average increase in value of 8.4 percent. Over the past 12 months, it has even posted a strong gain of 16 percent, including dividends. This is just under 1.5 percentage points less than the S&P 500. In addition, European equities are favorably valued compared to US stocks.

Valuations in the USA are getting out of hand

Speaking of valuations, if you take the overall U.S. stock market, its valuation on a P/E basis is 1.6 times as high as the overall European market. Since 1973, this is only the third time that this valuation divergence has been so high.

But there is another multiple to look at: the price-to-book value. While the price-to-book value in the USA has risen from 1.4 to 4 since 2009, it has stagnated in Europe. Here, it has remained unchanged at between 1.2 and 1.6 times over the corresponding period. Hence, based on the pbv-multiple companies in the USA appear to be significantly more expensive, valued two-and-a-half times as high compared to its European peers.

If you want to get in on the hype about AI, you can't get around the USA. Chat GPT can be played via Microsoft stock. But the stock is already very ambitiously valued by now. The company is currently worth more than US $2.5 trillion. This puts the value of the Redmond-based company somewhere between the gross domestic products of France and Italy. That is already a very ambitious number.

P/E ratio of over 200: Is there room for imagination left?

But we are now focused on Europe. And even if we were to invest globally, Microsoft would not be in our portfolio. The valuation is simply too high. Not that we misunderstand each other: Microsoft is a very good company that has never made even a hint of a loss in recent decades. But the recent rally is solely due to the hype around Chat GPT. And hypes are none of our business. Take Nvidia as an example. At the current share price Nvidia trades on a P/E ratio of 206. Its market capitalization has increased tenfold in the last 10 years. To invest in a company with a P/E ratio of over 200, you have to have a lot of imagination to find a reasonable upside here, other than "the trend is your friend". But that is pure momentum investing. And that clearly contradicts with our Contrarian Value approach.

P/E ratio of the Contrarian Value Euroland fund: 6.4 - return of 15 percent

We prefer the companies in the portfolio of our Contrarian Value Euroland fund and their favorable valuations. Renault, for example, has a P/E ratio of 3.4, Deutsche Bank 4.5 and Italian utility Eni 5. The P/E ratio of the portfolio as a whole is 6.4. The companies don't have to grow much, and slight setbacks are easy to digest. We can live very well with a comfortable return of 15 percent.