European honeymoon

Percival Stanion sees attractive opportunities in European and UK equities

It may not last, but Europe is enjoying a honeymoon period. For politicians this is an opportunity to lay the foundations for a more stable future while for equity investors it is a chance to earn decent returns from European stocks.

The euro zone has managed to navigate through a run of potentially treacherous elections without steering into extremism. The new French president Emanuel Macron, in particular, has been given an unexpectedly strong mandate to pass some meaningful reforms (although, of course, this will not be easy). His apparent rapport with German Chancellor Angel Merkel also opens the door to euro zone-wide initiatives.

At the same time, the smooth takeover of Spain's struggling Banco Popular by bigger peer Santander has shown what can be done when there is the political will to steer through banking reforms. It creates a potentially workable blueprint to fix other banking problems, including in Italy.

Economically too, this is a relatively benign period for Europe as it follows the US through the monetary policy and business cycles. We believe this feel-good environment of stronger growth, which is allowing political reform, is likely to last for at least another six months to a year.

We are therefore positive on European stocks, and on the region's banking sector in particular.

Turning more positive on UK

We are also – despite the somewhat unexpected election outcome – dipping our toes back into the UK stock market, which we had shunned for most of the past two years. While the current political situation brings a degree of uncertainty over the very short term, we think it may actually offer some positive news both for the economy and for parts of the financial market over the longer run.

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From the point of view of the British economy, it looks like austerity is now off the table and we expect to see some fiscal stimulus. That is what the Democratic Unionist Party has pushed for in exchange for its support of the Conservative government, and that is what the voting patterns appear to signal the British public desires following years of squeezed living standards. (In the year to April, for example, average regular pay increased 1.7 per cent while consumer prices rose by 2.7 per cent.)

The economy should also get some support from a more competitive exchange rate and low interest rates.

For the UK stock market, the combination of a weak sterling and fiscal expansion is generally a positive one. At the same time, UK equities look relatively cheap compared to both continental Europe and the US, which should help attract investment flows and spur merger and acquisition activity.

The UK's political instability hasn't weakened the case for UK equities. If anything, that case is now marginally stronger.

In terms of Britain leaving the EU, we don't think the election ultimately alters the general trajectory, but it does look likely that the tone of the British negotiation stance will be less strident.

EU politicians, meanwhile, may well want to deal with Brexit as quickly as possible. Merkel and Macron probably do not want the next two years of EU summits to be dominated by the Brexit process because that time could be the opportunity to move Europe forward. If Macron is serious about creating a more federal Europe, then now is the time to do it.

Seize the day

However, one has to bear in mind that the benign economic period in Europe will not last for ever. The longer-term fallout from Brexit is uncertain, while the euro zone still has many structural problems to resolve, not least in Italy. Come the next downturn, Europe could have strongly motivated and increasingly well-organised populist forces to contend with once again.

That makes it all the more important that politicians take advantage of the opportunities on offer while they last. The same applies to investors.

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