

European Recovery Fund signals greater unity and regional economic support

By: Christopher M. Dyer, CFA | July 21, 2020

London - Today an important part of the case for international equity fell into place with the leaders of the 27 countries of the European Union (EU) agreeing to pass the euro 750 billion European Recovery Fund, a stimulus package designed to address debt of individual countries across the EU.

We have previously argued that we expect the greater European cohesion that has evolved in recent months will play an important role in reducing the equity risk premium in Europe — boosting valuations of European equities, accelerating the economic recovery on the continent, and increasing the relative attractiveness of European equities. The approval of the Recovery Fund is the most concrete example to date of European cohesion in addressing both the near-term and structural economic challenges facing the region.

Significance of European Recovery Fund

Why is this stimulus package so significant? Because, using debt held at the EU level, critical financial assistance in the form of grants and low-interest loans is being provided to the poorer countries of southern Europe which have been hardest hit by the current crisis. The use of commonly held EU debt being deployed to support individual countries simply has not been done before — it's unprecedented — and will likely serve as a model for future responses to economic crises in Europe.

What are the implications of this EU agreement for global equity markets? Europe represents roughly 66% of the international equity market, which trades at a multi-decade low valuation relative to the US. The European Recovery Fund, and all that it represents, should accelerate economic growth in Europe, reduce the significant valuation discount of European equities to the US, and support what we believe is the very early stage of a multi-year period of outperformance of international equity.

Bottom line: We believe today's passage of the European Recovery Fund represents a milestone achievement toward fostering greater European cohesion and economic growth. We think international stocks represent a significant multi-year opportunity for equity investors, particularly relative to US equity markets.

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