

# Quarterly Equity Outlook: Rotation into value favors European stocks



**Edward J. Perkin, CFA**  
 Chief Equity Investment Officer  
 Eaton Vance Management

- Investors are not positioned for positive surprises.
- Improving sentiment on the economy could lead to a violent rotation into cyclical value sectors.
- In a rotation into value stocks, Europe has the potential to do well.

Equities		Current View					Notes
		-	+			+	
<b>Regions</b>	U.S.				✓		U.S. economy outperforming, but valuations more attractive elsewhere.
	Europe				✓		Valuations attractive. Cyclical economy can benefit from improving global trade.
	Japan				✓		Corporate governance improving: higher returns on invested capital (ROIC) and lower financial leverage. Valuations reasonable.
	Emerging Markets (EM)				✓		China trade deal seemingly likely, valuations attractive.
<b>Sectors: 3 Most Favored</b>	Consumer Discretionary				✓		Quality companies with good returns, low financial leverage.
	Financials				✓		Yield curve seems likely to steepen.
	Healthcare				✓		Cheapest defensive sector, but comes with political risk. Pick your spots.
<b>Sectors: 3 Least Favored</b>	Consumer Staples	✓					Anemic growth, balance sheets have taken on debt, and valuations high.
	REITs				✓		Recent outperformance leaves sector vulnerable.
	Utilities		✓				Recent ETF inflows into utility stocks have been high, a contrarian signal.



## Europe's relative performance to US has closely tracked value vs growth stocks

### Relative performance of MSCI Europe Value to MSCI Europe Growth and MSCI Europe to MSCI USA (12/31/02 to 09/19/19)



Source: FactSet, MSCI. Data as of 09/19/19. Indexed to 100 as of 12/31/02.

MSCI Europe Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across the 15 developed markets (DM) countries in Europe, with value investment style characteristics for index construction defined using three variables: book value to price, 12-month forward earnings to price, and dividend yield.

MSCI Europe Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics across the 15 DM countries in Europe, with growth investment style characteristics for index construction defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend.

MSCI Europe Index captures large- and mid-cap representation across 15 DM countries in Europe, covering more than 400 constituents and approximately 85% of the free float-adjusted market capitalization across the European DM equity universe.

MSCI USA Index is designed to measure the performance of the large- and mid-cap segments of the U.S. market, covering more than 600 constituents and approximately 85% of the free float-adjusted market capitalization in the U.S.

It is not possible to directly invest in an index. Index returns do not reflect the effect of any management fees, transaction costs, or expenses.

**Past performance is not a reliable indicator of future results.**

### Against the Grain

A contrarian take on the market

### “Go to Europe for value”

U.S. travelers like to vacation in Europe when the dollar is strong and local prices offer good value for money. U.S. investors should follow this same logic by looking across the pond for good values to pick up in the stock market.

One of the most popular discussion topics in the equity market is the significant outperformance of growth stocks over value stocks during the past decade. Valuation disparities between steady growth and cyclical value are at historically wide levels.

For those of us who believe in value investing, the natural question is when value will come back into vogue. If and when value stocks do have a resurgence, the benefit is likely to be felt most strongly beyond our shores. Europe (and Japan, too, for that matter) offers cheaper prices and more upside from improving sentiment around trade tensions and global economic growth than the U.S. market.



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### For further information, please contact:

Eaton Vance Management  
Two International Place, Boston, MA 02110  
800.836.2414 or 617.482.8260 | [eatonvance.com](http://eatonvance.com)

Eaton Vance Management (International) Limited  
125 Old Broad Street, London, EC2N 1AR, United Kingdom  
+44 (0)203.207.1900 | [global.eatonvance.com](http://global.eatonvance.com)

